SUBMISSION

to

THE RESTRICTIVE TRADE PRACTICES COMMISSION

ON

THE STATE OF COMPETITION IN THE CANADIAN PETROLEUM INDUSTRY

ARGUMENT

TEXACO CANADA INC.

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PREFACE

After more than 10 years of investigation, harrassment and public vilification of Texaco Canada and its refiner-marketer competitors, the office of the Director of Investigation and Research (the ''Director'') is finally being called to account. In February 1981 the Director published Green Books that were said to have been based on evidence and factual material demonstrating monopolistic conditions and practices in restraint of trade of such importance as to require the enormous expense, disruption and commercial uncertainty that results from a lengthy public inquiry.

Accordingly, an inquiry was directed. The Director requested a hearing before the Restrictive Trade Practices Commission (the ''RTPC'') so that a government tribunal could review, in public, the Director's evidence and material that allegedly supported the Green Book conclusions of monopolistic conditions and restrictive practices.

> The report of the Commission to the Minister pursuant to Section 19(2) of the Act will review the evidence and material, appraise the effect on the public interest of arrangements and practices disclosed in the evidence and contain recommendations as to the application of remedies provided in the Act or other remedies.
>
> (Green Books, Volume I, page 1)

When it completes such review, and having come to its own conclusions, the RTPC has the duty to report to the Minister whether any such conditions or restraints existed, whether it has made any other findings with respect to other public interest issues and, if appropriate, to recommend remedies for competitive deficiencies.

The Director was provided every opportunity to present his evidence and material and to justify his conclusions. He was challenged to present his evidence, to justify his conclusions or to withdraw his Green Books. Texaco Canada joined a chorus of its competitors in characterizing the Green Books as inaccurate, biased and unfair. It presented knowledgeable witnesses to explain the company's policies and activities during the years under review.

Having given all designated parties an opportunity to present their evidence and having by its counsel adduced such other evidence as it considered useful, the Commission has now concluded its task of receiving the evidence upon which it will rely in making its findings as to the state of competition in the industry. The Director has concluded his evidence and has delivered his written submission as to the substantive issues at the hearing.

It is submitted that the time has come for the RTPC and indeed, the Canadian public, to demand an answer to the following questions:

1. WHERE IS THE DIRECTOR'S EVIDENCE, MATERIAL AND SUBMISSIONS TO SUPPORT THE GREEN BOOK FINDINGS AND CONCLUSIONS?
2. WHY HAS THE DIRECTOR ELECTED TO IGNORE SO MANY OF THE DEFAMATORY AND ANTI-COMPETITIVE ALLEGATIONS IN THE GREEN BOOKS THAT CREATED ANGER AND DISTRUST ON THE PART OF SO MANY MEMBERS OF THE PUBLIC AND INDEED THE GOVERNMENT AGAINST MAJOR OIL COMPANIES OPERATING IN CANADA?

3. IF THE GREEN BOOKS CANNOT BE PROVEN, WHY ARE THEY NOT WITHDRAWN?

Texaco Canada presents its final Argument on the substantive issues by examining the relevant evidence and concerns presented at this hearing in support of the following submissions:

INTERNATIONAL

1. Texaco Canada did not, as alleged in the Green Books, buy crude oil at prices in excess of fair market value, and retail prices of petroleum products were not kept artificially high by reason of such excess costs.
2. The RTPC should reject the suggestion of some of the Director's witnesses that the fairness of prices paid by Texaco Canada should be based on the cost of production, rather than on prices asked and paid on world markets.
3. The RTPC should reject the allegation that Canada's National Oil Policy was adopted to serve the interests of Ontario refiners who were intent on exploiting Canadian consumers.
4. No justification has been tendered for the suggestion that petroleum companies with multinational connections should be subject to rules different from those governing other large Canadian businesses.

RELATIONS BETWEEN REFINERS

1. The Green Book allegations that arrangements between refiners stifled competition and encouraged parallel anti-competitive behaviour are unproved and false.
2. Reciprocal product exchange arrangements of both long and short term reduce transportation costs, encourage competition and benefit the public.
3. Healthy and vigorous competition exists between Canadian refiners, resulting in efficiencies by the refiners and cost savings for Canadian consumers.

THE MARKETING OF PETROLEUM PRODUCTS

1. The Green Book allegations of predation and monopolization are preposterous and untrue.
2. Healthy and vigorous competition exists between petroleum marketers in Canada, except to the extent that such competition is inhibited by government regulation.
3. Government regulation should not support smaller inefficient operators merely because they are small and risk weakening the more efficient marketers even if they are large or are refiner-marketers. We must not confuse the expected consequences of competition with predation and discipline. There should be no government guarantees of success. All marketers, big or small, should only have the right to try.
4. The legitimate competitive concerns and questions about competition in the marketing of petroleum products should be approached as part of an analysis of Canada's competition policies generally and having regard to the interests of all Canadians.

CONCLUSIONS

The RTPC should report as follows to the Minister:

1. The Green Book conclusions of monopolistic conditions and restrictive trade practices are not supported by evidence received at the Inquiry.
2. The Minister should require the Director to limit statements of evidence and material filed under the Act to statements based on fact and supportable by evidence and argument to prevent unnecessary damage to Canadian businesses.
3. The petroleum industry in Canada remains highly competitive. Concerns about the financial welfare of some competitors should not be resolved by legislation specific to one industry.

March, 1984

Claude R. Thomson, Q.C.
Randal T. Hughes

Counsel to Texaco Canada Inc.

PART ONE

INTERNATIONAL

I. INTRODUCTION

The Director continues to maintain that Texaco Canada and its principal competitors acted in concert and abused their alleged market power by paying excessively high prices for crude oil. According to the Director, Canadian refiners for many years were jointly motivated to benefit foreign producers and sellers to the detriment of Canadian shareholders and consumers.

As part of his overall theory of coordination and in order to make his international allegations appear economically rational, the Director asserted that major Canadian refiners promoted and utilized Canada's National Oil Policy in order to charge excessively high prices for products manufactured from domestic crude oil.

Present as well, but irrelevant to this Commission's concern with competition policy, was the suggestion that Texaco Canada, like most other Canadian refiners, was guilty of evading payment of lawfully due Canadian income tax and improperly obtaining payment from the Petroleum Compensation Board as a result of its alleged policy of paying excessive prices for imported crude oil.

All these allegations are false. Neither in the Green Books nor at the hearings did the Director make any effort to establish their truth by credible evidence. Based as they are on a biased, unfair and inaccurate analysis of Texaco Canada's conduct and of the petroleum industry in Canada, they should be rejected by this Commission. The only credible and sworn evidence that was presented demonstrates that Texaco Canada has, at all times, acted efficiently and in the best interests of all of its shareholders and customers. The price that it paid for its slate of imported crude oil enabled the company to compete effectively in the retail, commercial and wholesale petroleum product markets throughout Canada.

II. TEXACO CANADA DID NOT PAY EXCESSIVELY HIGH PRICES FOR IMPORTED CRUDE OIL

The relevant evidence is extensive. During the course of the hearing Texaco Canada filed detailed, written submissions, provided answers to requests for information and presented a panel of knowledgeable company officials for examination by the Commission and the Director. Texaco Canada's position is detailed in its written submission entitled ''International Linkages — Canada and the World Petroleum Market, 1958-1982'', Exhibits I-156A and B (''Texaco's International Submission''), the oral evidence of Texaco Canada's witnesses (Transcript Volumes 75-77) and in Texaco Canada's response to undertakings at the hearing and supplementary requests for information (Exhibits I-277, I-278, R-122 and I-382). No useful purpose would be served by reiterating here the evidence and submissions presented earlier.In the following analysis, Texaco Canada draws on that material and other relevant information to show that the Director's allegation is without support.

The Director attempted to justify his assertion by two inconsistent analyses of the facts.It was sometimes suggested that prices paid by Texaco Canada and its competitors were higher than fair market value in the sense that Canadian refiners could and should have acquired

crude oil at significantly lower prices. At other times, because the authors of the Green Books and the Director's witnesses could not find alternate suppliers of crude oil of suitable grade offering secure term supply at lower prices, they looked outside the real market and presented theoretical ''implicit'' prices that, in their view, should have prevailed in world markets.

A. The Prices Texaco Canada Paid for Imported Crude Oil were Fair Market Prices

The Director used three methods in his effort to demonstrate that Texaco Canada paid prices exceeding fair market prices for crude oil:

(a) He compared Texaco Canada's prices with theoretical or ''implicit'' prices derived from transactions at very low prices that he found;

(b) He compared Texaco Canada's prices with prices paid by some Canadian importers that were at the low end of the range of fair market prices; and

(c) He compared Texaco Canada's prices with prices that he believed should have prevailed in world markets.

As we show below, none of these methods was appropriate.

(a) Texaco Canada's prices were indeed higher than the theoretical or ''implicit'' prices the Director calculated, but that is only because the Director's calculations are wholly unrealistic. In making these calculations, the Director used understated freight charges, relied on low prices that prevailed only for a relatively brief time in Rotterdam and ignored transit losses and costs of insurance. Naturally, such prices turned out to be below the prices actually paid by Canadian refiners. Comparing real prices with such artificially low theoretical prices cannot show that the real prices were excessively high.

(b) Since crude oil prices are subject to negotiation, it is not surprising that while they varied, they fell within ranges reflecting world market conditions. To advance his position, the Director has deliberately focused on low prices that from time to time were obtained by smaller Canadian refiners on world markets.

The Director failed to assist the Commission by showing the real prices that prevailed in the world markets in which the majority of crude oil was traded. He also ignored the evidence of government officials and documents showing that Canadian refiners were among the lowest priced importers of crude oil during the relevant years.[1]

The failure of the Director's witnesses to present evidence of an actual range of world market prices stands in sharp contrast with what the Director said he would present to this Commission. In the opening statement entitled ''International Linkages'', the Director announced his intentions during the International phase of the Inquiry. He said:

> 1. *The transfer prices charged to Canadian subsidiaries by their foreign parents for crude were in excess of fair market value.*
>
> The Director's position in this area is quite clear. The crude prices charged by foreign parents to their Canadian subsidiaries were in excess of fair market value for such transfers. Evidence will be brought before the Commission analyzing transaction prices in the open market throughout the period under consideration from 1958 to the present. This evidence will support the findings and conclusions of the Director in Exhibit A-2

> that during the period, the subsidiaries of the major multinationals were consistently charged unrealistic transfer prices for crude that were higher than *world market or arm's-length prices*. (emphasis added).......
>
> The majors in their opening statements criticized the prices used by the Director as being either spot prices or not representative of long-run supply commitments. The Director intends to call evidence that will show that the criticisms voiced by the majors are unfounded.

The promised evidence has not been presented.[2] Without this evidence, the Director's conclusion is unsupported.

The Director attempted to justify his conclusion by referring to the mechanisms used in some international crude oil transactions. At page 5 of his opening statement and following, the Director describes the ''off-shore traders'' used allegedly to extract excessive prices. Again he promised evidence:

> The evidence will show that the majors utilized off-shore trading companies as part of the transfer pricing process. Off-shore traders were a mechanism used by the integrated oil companies to divert profits out of Canada through the use of affiliated companies designed to create a series of paper transactions between the crude source and the Canadian subsidiary. Some examples of the use of off-shore traders are:
>
> (a) *Texaco*
>
> Texaco Canada Limited received Saudi Arabia crude oil from Aramco through a chain which included Texaco Carrier Ltd. (''Texcarrier''), Texaco Trading Company Limited (''Textrad'') and Texaco Overseas Petroleum Company (''TOPCO'').
>
> The sizeable transfer price premiums paid by the Canadian subsidiaries resulted in Canadians paying higher product prices and transferred off-shore to various tax jurisdictions both the profit earned from Canadian business and as well taxes payable thereon.

Nowhere in the evidence is there the slightest suggestion to support this outrageous allegation against Texaco Canada and other Texaco companies. Apparently, the Director is more interested in criticizing oil companies than in ascertaining the facts.

(c) Finally, the witnesses called by the Director sought to show that prices paid by Canadian refiners were above fair world market prices by ignoring real prices and creating theoretical models based on cost. These witnesses also suggested that Canadian refiners and consumers (like all refiners and consumers in the Western world) have been the victims of a multinational monopoly and conspiracy resulting in the payment of excessive prices for crude oil. But this analysis is merely a tissue of assumptions without evidence, and in any event fails to show that the prices Canadian refiners paid were in excess of the range of actual prices paid in world markets. The witnesses' theoretical model is discussed in the next section of this submission.

In sum, the Director has failed to show that Canadian refiners paid prices in excess of world market prices. In fact, his experts did not try to do so, and to the extent that they looked at the issue, reached the opposite conclusion:

> (Thomson) Were you asked the question of whether or not over the years from 1964 to 1981 the Canadian consumer and Canadian refiners paid more than other consumers and refineries in other parts of the world for oil from the Middle East?
>
> (Davidson) No, I was not asked that question.
>
> (Transcript Volume 66, page 12622)
>
> (Chairman) In other words, you are basically, I think, telling us that since 1974, Canadians have not been paying higher crude prices than other purchasers throughout the world.
>
> (Davidson) This of course is the evidence of Mr. Brant.
>
> (Transcript Volume 70, page 13285)

Thus, the Director's own witnesses refute the allegation that Canadian refiners paid excessively high prices as judged by the standard the Director proposed.

B. The Director's Reliance on Tax Paid Cost is Unrealistic

In view of the absence of evidence that Canadian refiners paid prices in excess of world market prices for crude oil, it is not surprising that the Director's witnesses sought another benchmark for evaluating whether Canadian refiners paid excessively high prices. But the benchmark they chose, tax paid cost, is wholly inappropriate and unrealistic.

The Director's witnesses explained that they sought a benchmark to substitute for fair market value because so much of the crude oil in world markets is sold through integrated channels:

> The great difficulty in any transfer pricing analysis is to determine the fair market value of the transaction. The difficulty arises because fair market values are not immediately apparent where the bulk of the product travels constantly through fully integrated companies. There are simply very few actual market prices to use for the basis of the calculation.
>
> (Exhibit I-16, pages 16-17)

Kirby Brant concluded that an appropriate substitute for a real ''fair market price'' is a price that can be determined by calculating the tax paid cost. The reason for using such a calculated benchmark cost, according to Mr. Brant, is that multinational companies could make a profit selling crude oil at tax paid cost because of the tax advantages they would receive through tax credits in the United States. He maintained that position even though some companies could not take advantage of such credits.

When Mr. Brant returned with Dr. Paul Davidson he acknowledged that it might be appropriate to include a reasonable return on capital employed. Thus, the Director's panel concluded that transfer prices in excess of tax paid costs and a reasonable return on capital gave rise to competition concerns and would justify government intervention.

The calculation of hypothetical prices and their application to world markets that are assumed to be competitive is of no assistance in evaluating the reasonableness of the real

prices paid by Canadian refiners in the real market. For reasons beyond the control of Canadian refiners, international crude oil markets have been largely controlled by OPEC, a cartel of oil producing states. OPEC does not set its prices so that oil trades in world markets at the ''competitive supply price.'' World market prices are not competitive prices. Thus, a Canadian refiner paying world market prices would, by the Director's proposed benchmark, be found to be paying excessively high prices, even though no lower prices were available in world markets. This submission is consistent with the position of the United States Department of Justice, which recently concluded that any exercise of market power in international oil markets was outside the control of multinational oil companies and outside the reach of U.S. laws. (See report of William F. Baxter, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, December 7, 1983.)

In summary, the proposed benchmark is unrealistic and not helpful for the following reasons:

1. The market power of producing countries is outside the control and jurisdiction of this Commission and the Canadian Government.
2. Crude oil, like other commodities, is bought and sold at market driven prices. It is not sold at prices calculated on the basis of tax paid costs plus return on investment.
3. Basing policy on tax paid costs plus return on investment would require a complicated and expensive regulatory scheme dependent on access to records held outside of Canada, many of which are under the exclusive control of foreign oil producing states.
4. Basing policy on tax paid cost plus return on investment would produce the following anomalous and unrealistic results:
   (a) Tax paid cost and therefore the benchmark price for identical crude oil could vary significantly because production costs will differ substantially between producers and because tax rates at the production level can differ dramatically.
   (b) Return on capital will involve a different analysis in the case of each producer and, therefore, the appropriate rate of profit and the benchmark price would vary because of considerations that have no relation to the demand for oil or the price the market would establish.
   (c) Different purchasers would be expected to pay different prices. For example, the panel recognized that Petro-Canada, because it is not affiliated with a multinational company, would be expected to pay official selling prices. On the other hand, Texaco Canada's purchase price for crude oil purchased from its majority shareholder would be judged by the producer's tax paid costs plus return on investment. Non-affiliated purchasers from the same source would presumably be expected to pay whatever the seller could obtain in arm's-length sales, a figure which might well differ from the panel's benchmark price.
   (d) Any policy that would require that Canadian refiners pay no more than the panel's benchmark price would require that Canadian refiners refuse to pay world market prices for crude oil. The suggestion that Canadian refiners should refuse to pay world prices and should lead a war against producing countries cannot be taken seriously. (See Transcript Volume 66, pages 12621-27 and Volume 68, pages 12787-811, testimony of Mr. Brant and Dr. Davidson.)

The Director's panel elected to ignore arm's-length transactions in crude oil and the real market prices established by producing countries. It therefore arrived at unreasonably low benchmark prices that bear no relation to reality. Any policy based on such a benchmark price would be unrealistic, punitive and unworkable.

C. Texaco Canada's Evidence was Corroborated at the Hearing

Texaco Canada's evidence made it clear that its purchasing policies were more beneficial than any other option available in world markets. Of great significance is that the Commission heard evidence from government witnesses, from Petro-Canada and even from the Director's witnesses demonstrating beyond doubt that prices paid fell within the range of prevailing fair market prices.

1. National Energy Board, Department of Energy, Mines and Resources and Petroleum Compensation Board Testimony

Peter Scotchmer, A. J. Kealey and Roland Priddle were independent and knowledgeable witnesses as to industry practice. Their evidence contradicted the Green Book assertion that Canadian refiners would have been more cost efficient if their crude purchases had been from non-integrated channels.

According to the evidence, both the National Energy Board and the Department of National Revenue were watchful for excessive crude oil pricing over the years under review. If there had been excessively high purchase prices (and certainly if such prices were harmonized among the companies), Canadian government officials would have known of it. Yet these officials do not support the Green Book allegations.

Curiously, in preparing the Green Books, the Director's staff apparently ignored the help that was available from knowledgeable government departments. At the time that officials of the National Energy Board undertook to cooperate in the Director's supposed fact finding exercise, Exhibit I-149 was delivered to the office of the Director. That exhibit (a copy of which is included as Appendix I) is inconsistent with the Green Book allegations of monopolization and rip-off. It is not referred to at all in the Green Books. Why did the Director ignore the help that was available? This is a further example that supports the submission made in our opening statement that the authors of the Green Books were not engaged in an objective search for truth.

In fact, Mr. Priddle testified that during the period from 1973 to 1981, Canadian importers were, in the majority of cases, paying less than the International Energy Agency (''IEA'') average at FOB for the grades of crude oil that could be compared — and for Saudi Light, Canadian importers were amongst the lowest price purchasers (Transcript Volume 42, page 8643. Also see Exhibit I-39, page 7 and Exhibit I-25, page 3). This testimony, of course, is inconsistent with the claim that Canadian refiners paid excessively high prices for crude oil during this period.

Mr. Priddle also referred to an important reason why Canadian refiners would not have willingly paid excessively high prices. Imported petroleum products remained a significant competitive factor in Canadian markets. As a result, higher prices paid for crude oil by any refiner competitor could not be passed on by way of price increases within the competitive product markets that existed in Canada. (See evidence of Mr. Priddle, Transcript Volume 44, page 9038 and Mr. Scotchmer at Transcript Volume 74, pages 14052-53.)

2. *Petro-Canada Testimony*

John Bechtold of Petro-Canada, a witness for the Commission, responded to a question asked by the Chairman by agreeing that, apart from the spot market, there is little flexibility in price for a buyer of crude oil in today's world markets; the official selling price generally prevails (Transcript Volume 43, pages 8932-33).

This statement is hardly surprising. The evidence demonstrated that the prices of Canadian domestic crude oil are controlled by Canadian governments. The prices of Mexican crude oils to Canadian customers are negotiated between Petro-Canada and the government of Mexico. The prices of crude oils in Venezuela are set by the government of that country, which, through its agency, deals directly with refining companies seeking to acquire supplies. As well, the prices of foreign crude oils in other OPEC and non-associated countries from which Canada imports crude oil are largely controlled by the governments of those countries. By and large, crude oil prices are determined by governments, and there is little the buyer can do to change those prices.

Petro-Canada witnesses also explained why affiliation with a multinational company is beneficial despite the lack of price flexibility in world markets. They asserted that it would be advantageous to any refiner to have access to the pool of crude oils (such as typically is arranged by multinational companies) and be able to take advantage of the purchasing practices of these oil companies (Transcript Volume 43, pages 8888-91, 8897, and 8918).

3. *Kirby Brant's Testimony*

The Director's witness, Kirby Brant, testified to the lack of flexibility in international crude oil prices. In response to a question of the Chairman, Mr. Brant said he believed that there would be little difference in the price at which crude oil could be acquired today from exporting countries whether the buyer is an independent company, one of the affiliates of a multinational or an importing nation (Transcript Volume 39, page 8324). Later, Mr. Brant said that beginning around 1960, when the OPEC producing countries took control of the price mechanism, it was impolitic, if not impossible, for the producing companies to set the posted price (Transcript Volume 70, page 13290).

III. PRICES PAID BY CANADIAN REFINERS WERE NEITHER IDENTICAL NOR COORDINATED

The Director's allegation of coordination or conspiracy is necessary to support a competition issue. The Commission must seriously address the question as to why the authors of the Green Books and the Director's evidence failed to explain the basis for this serious allegation. The Director proved that different refiners paid different prices. The Texaco witnesses were not confronted with the allegation that Texaco Canada's prices were determined by relation to prices paid for crude oil by any competitor. The evidence was to the contrary. The Director has now qualified his earlier allegations, arguing that he did not contend that importers paid ''exactly'' the same prices, but only that ''a number'' of companies (unnamed) were ''guided'' by prices paid by their competitors. (See letter of March 13, 1984, page 3.)

The evidence demonstrated such a disparity of crude oil grades, prices and freight costs as to make "harmonization" or collusion impossible. (See Texaco's International Submission, Volume A, pages 43-46.) The evidence demonstrated that all Canadian refiners had the same objective: to obtain security of supply and the best prices available in order to compete as effectively as possible for customers in Canada.

IV. THE DIRECTOR'S SUBSIDIARY ALLEGATIONS ARE UNSUPPORTED BY THE EVIDENCE

A. Texaco Canada and Its Principal Competitors Did Not Promote and Utilize Canada's National Oil Policy in Order to Charge Excessively High Prices for Products Produced from Domestic Crude Oil.

In the Green Books, but not at the hearing, the Director alleged that the National Oil Policy was adopted by Canada to serve the interests of Ontario refiners who were intent on exploiting Canadian consumers. Texaco Canada presented a written brief and demonstrated that the Director's allegations are false and arise from an improper and biased analysis of government policy and industry practice.

What is perhaps most significant is that when Texaco witnesses were presented to support Texaco Canada's position, those witnesses were not confronted with the allegation or any evidence to support the assertion in the Green Books with respect to the National Oil Policy. The facts are set forth in Volume B of Texaco's International Submission. The statements in that submission were supported by the sworn testimony of the panel of witnesses that was produced for examination and cross-examination. Texaco Canada's evidence is uncontradicted and should be accepted.

B. Texaco Canada Did Not Evade or Attempt to Evade the Payment of Lawfully Due Income Tax in Canada

In his statement on International Linkages and from time to time during the hearing, the Director suggested that Texaco Canada was guilty of evading and attempting to evade payment of income tax by paying excessively high prices for crude oil in order to improperly reduce taxable income in Canada. This allegation, of course, raises no issue of competition policy, but rather is a matter for the Department of National Revenue. Texaco Canada submits that, particularly in the absence of evidence, it is outrageous to suggest that the officials of the Department of Revenue are not capable of performing their statutory duty.

V. RESPONSE TO THE DIRECTOR'S NEW ARGUMENT

The Director's Argument is similar in structure to Volume III of the Green Books. In order to justify its recommendations, it ignores sworn evidence, asserts conclusions founded on suspicion and distorts the contents of seized documents. The Director picks scattered prices that suit his argument in order to make it appear that a systematic analysis of market prices was made. He also retreats to the efforts by his witnesses to establish a theoretical benchmark price which was completely removed from real prices that prevailed at any time.

The Director has once again presented a biased analysis of irrelevant information which has already unnecessarily diverted the Inquiry from the real competition issues that should be addressed.

In addition, the Director developed a submission allegedly founded on the evidence given by Dr. David Shaw. The Director's elaborate reanalysis of Dr. Shaw's economic and accounting model is not useful to the resolution of any of the issues here. It begins by assuming (as did Dr. Shaw) what the Director has failed to prove: that Canadian refiners paid excessively high prices for crude oil. By changing Dr. Shaw's assumptions, the Director forces answers that suit his purpose. If the Director had intended the Commission to take this argument seriously, he would have presented documentary support and a witness for cross-examination.

Finally, in order to justify a "remedy" when changes in international oil markets have rendered the Director's historical analysis irrelevant, the Director presents an inaccurate view of the policies and practices of Canadian government agencies and conjecture about current pricing behaviour.

The Director's analysis is illogical and inconsistent. If there is a competition problem to be remedied today, he has failed to identify it with any kind of precision that permits discussion. If the Director's position becomes clearer, Texaco Canada will probably have something more to say.

At page 4 of his Argument, the Director, with some apparent arrogance, makes the submission that there is no doubt that there was an overcharge and that the main dispute is as to the amount. Obviously, the Director is deliberately ignoring the evidence and the stated position of all the oil companies. We are confident that the Commission will not take this statement seriously. We now propose to respond to the parts of the Director's Argument that make allegations against Texaco Canada.

A. Assertion of the Overcharge

The Director's allegation of overcharge against Texaco Canada is founded on four arguments.

> 1. *An internal Imperial Oil document in 1968 calculated Texaco Canada's crude cost during 1967 and part of 1968 as being 30¢ to 40¢ above fair market value (Director's Argument, pages 18, 19 and 33).*

The internal Imperial Oil document was in error because Imperial did not know the actual prices that Texaco Canada was paying for its crude oil.

Imperial had estimated that Texaco Canada's FOB cost for Arabian was \$1.78 FOB Ras Tanura or \$2.15 FOB Sidon. Actually, Texaco Canada's CIF cost at Portland was \$2.33 per barrel and the derived FOB cost at Ras Tanura using AFRA freight and ½% loss as shown in Table 10, page 36 of Texaco's International Submission, Volume A, was \$1.45 for 1967 and \$1.38 for 1968. Therefore, the difference between Imperial Oil's estimate and the actual cost was 33¢ to 40¢, which would indicate that the FOB costs were comparable to what Imperial apparently considered to be fair market value.

It is important to remember that Texaco Canada's evidence to this Commission demonstrated that its CIF cost at Portland was \$2.33 as set out above. In other words, it must be obvious to the Director now that the price used in the Imperial document was inaccurate. Perhaps the Director will tell us in his reply why he persists in relying on an inaccurate

internal Imperial document against Texaco Canada. Of some interest also is why Texaco Canada witnesses were not asked about this matter if the Director has any reservation as to the accuracy of Texaco Canada's response as presented here.

2. *In 1972 Texaco Canada learned from the National Energy Board that in 1970 its crude costs were 12¢ per barrel higher than the average of the rest of the industry (Director's Argument, Volume 1, page 33).*[3]

This issue was explored at the hearing and the Director has elected to ignore the evidence. If Texaco Canada's crude oil costs were 12¢ a barrel higher than the average of the rest of the industry, that fact could well be explained by differences in crude oil grades, transportation costs, etc. For this reason, and since market prices for crude oil fall within ranges, the fact that during any particular period of time, Texaco Canada's prices are above an average but within the range, does not support the Director's allegation of overcharge.

On the basis of information provided by Dr. Howland, the former chairman of the National Energy Board, John Light, who held senior positions in the Refining department throughout the 1958 to 1973 period (incorrectly identified in the Director's Argument as the Vice-President of Transportation and Supply), concluded that the crude oil cost to Texaco Canada at Montreal was about 12¢ per barrel more than the average cost of similar crude oils to other refiners. Mr. Light used that information in making an argument to Texaco Inc. for an adjustment in the cost of crude oil at Montreal and Halifax in respect of the years 1969 and 1970.

Counsel for the Director questioned Texaco Canada's witness, Harry Hudson, about a document relating to these costs prepared by Mr. Light (Transcript Volume 75, pages 14346-47 and Volume 77, pages 14594-14603). Mr. Hudson explained that the National Energy Board provided Texaco Canada with a chart on which was shown a single line representing an industry average. It was then up to Texaco Canada to place its own information on that chart. Mr. Hudson's recollection of the chart provided by the National Energy Board was that it did not clearly indicate the actual crude oils covered by the average. It was therefore impossible to know whether Texaco Canada's costs for a particular grade of crude oil were high.

Whatever the chart actually showed about Texaco Canada's costs, it did prove to be a good negotiating tool. Using information derived from the chart, Mr. Light succeeded in his negotiations. Texaco Canada's Exhibit I-158 demonstrates price reductions that were secured for the year 1970.

3. *Memoranda of J.G. Light assert that Texaco Canada was paying too much for its crude oil.*

Mr. Light was Texaco Canada's negotiator with its majority shareholder. It was his responsibility to secure lower prices; he did so by arguing that Texaco Canada was paying too much for crude oil. The memoranda demonstrated that Mr. Light did his job extremely well.

The Director suggests in his Argument that Texaco Canada witnesses were critical and indeed insulting of Mr. Light, referring to him, among other things, as a "misguided bulldog". The Director argued that Texaco Canada witnesses "belittled" him, said he was "prone to exaggeration" and was subject to "delusions". The Director has distorted the evidence.

Mr. Light was a ''bulldog'' in the Churchillian sense, and he was and is admired by Texaco Canada management for his tenacity and single-mindedness. Like negotiators for other major petroleum companies, Mr. Light recorded on internal memoranda those assessments that he made of international crude oil markets that could help his negotiating position.

The Director persists in reading Mr. Light's statements out of context. He persists in interpreting them while ignoring the assistance of the responsible and credible witnesses who were presented by Texaco Canada to explain its policies and practices. Obviously, the Director's mind was made up when the Green Books were prepared, and he is not now open to evidence inconsistent with his conclusion.

From the documents and from the evidence, it must be apparent to everyone but the Director that it was Mr. Light's style to identify, concentrate on, record and tenaciously cling to any information or rumour that could support an argument for a lower price. Concurrently, it was his style to ignore any argument, rumour or piece of information that might lead to a different conclusion. He left those arguments to the other side of the table. Mr. Light was an advocate, not an analyst.

Texaco Canada presented a panel of knowledgeable witnesses to respond to all of the Director's questions with respect to issues raised in the International sector of this Inquiry. Considering the lengthy period of time under review, they were able to provide a remarkable amount of information. Because their evidence was inconsistent with the Director's case, he has in large measure ignored it in his Argument. (See Transcript Volume 75, pages 14231-33, 14353-63 and Volume 76, pages 14523-24.)

4. *From time to time Texaco Canada paid more for its crude oil than did some other companies in some of their transactions (Director's Argument, Volume 1, page 42 and following).*

The Director provided evidence of low prices that were paid for some crude oil bought by Petrofina Canada, Ultramar Canada, Murphy Oil and B.P. Canada. The Director failed to present witnesses to explain the basis upon which those prices were negotiated and their relation to prices generally being paid by third party purchasers.

The evidence called with respect to Petrofina is confusing. It is not accurate to say, as does the Director in his Argument, that the Petrofina dividend from its off-shore trader was referable to a mark-up in crude oil prices. It is noteworthy that the Director's analysis of the Petrofina documents and prices in the Green Books bears no relation to the analysis and conclusions that appear in the Argument.

In the 1960's, B.P. Canada was attempting to enter petroleum product markets in Canada. Its parent company was prepared to transfer crude oil to the Canadian subsidiary at low prices in order to stimulate market growth:

Q. (McDougall) Can you expand a bit on the rationale that, to your knowledge, led to the decision to come into Canada?

A. (Barclay) The rationale to expand, I think, was quite simple. It was this, that BP had access to large volumes of crude oil which it could not dispose of. It was being pressured by Middle East countries to increase the sales of crude oil and it either had to sell crude oil or it had to build refineries, process that crude oil and sell the products.

This was the strategy which it followed in the late 1950s.

Q. Was there an economic theory that underlay the decision to go into Refining and Marketing in Canada?

A. (Barclay) The economic theory, I think, was that it would be profitable to the BP group as a whole to sell crude oil and to refine that crude oil even though it made a small loss on the sale of the product since it then became a net seller of crude oil, it did increase its crude oil sales by that way.

(Transcript Volume 99, pages 18652-53)

Murphy Oil was apparently able to negotiate crude oil prices comparable to those of B.P. Canada while having its crude oil processed by B.P. Canada. The reasons for the apparent low price paid by Murphy Oil can be the subject of speculation but are not the subject of evidence.

Ultramar Canada purchased some crude oil that apparently had been purchased by its parent company from Exxon. Those prices were the subject of discussion when witnesses from Imperial Oil testified. At the time they were at the low end of the range of fair market prices.

In any event, the evidence of these isolated transactions cannot be an adequate substitute for a systematic analysis of world market prices. The only such systematic evidence in the record supports Texaco Canada's assertions that its prices were fair.

B. Other International Assertions

The Director's Argument on the International sector contains the following assertions:

1. Prices above a theoretical "competitive supply price" are excessive

In Section II of this Part of its submission, Texaco Canada responded to the notions and theories of the Director's witnesses. They are irrelevant to real market forces and ought to be rejected. In his Argument, the Director offers nothing new to the discussion.

2. Crude oil purchasing practices have been costly to the Department of National Revenue

The Director's allegation is outrageous. He delivered to Texaco Canada two versions of page 74, copies of which are included as Appendix II. Where is the real page 74? How can Texaco Canada be expected to reply to a blank page? The table suggests that $340,159,444 in costs claimed by six major oil companies were disallowed by the Department of National Revenue as a result of adjustments made because of excessive crude oil prices paid. That table may be of some interest to those who wish to attack the industry, but it does not belong before this Commission.

The Director refers to the evidence of Walter Szyc of the Department of National Revenue (Transcript Volume 36). The Director refers to reassessments issued by the Department between 1961 and 1979 relating to crude oil adjustments against major oil companies. These adjustments are indicated on the largely blank page 74 of his Argument. The Director notes that some reassessments are still before the courts. The only adjustments listed on the table provided to Texaco Canada are those relating to that company. While these figures are accurate, they total only $1,315,907, an insignificant portion of the aggregate

reassessments. The reassessments in respect of Imperial, Irving and Petrofina appear to involve the use of off-shore traders, and the Director has now belatedly admitted that (at least as to Imperial) the adjustment did not relate to crude oil pricing. (See letter of March 13, 1984, page 2.) Shell is not included in the table, presumably because it has convinced the Director that there are no reassessments now outstanding against it.

There was some discussion on this subject when Counsel for the Director asked to file this table, entitled ''Imported Crude Cost Adjustments by National Revenue.'' That exchange took place at Transcript Volume 183, pages 32597-32608. Commissioner Roseman pointed out that a number of the expense items disallowed by the Tax Department dealt with expenses of trading companies and that there is a considerable difference between that situation and the one where it was the full price paid to the parent that was disallowed (page 32598).

Mr. Kaiser made the suggestion, taken up by the Chairman, that an affidavit would be filed from an official of National Revenue ''...indicating in the case of each charge what the basis was, whether it related to overcharge of crude or whether it related to the subsidiary or what the circumstances were about it'' (Chairman, page 32606). Counsel for Imperial Oil suggested that the affidavit might also include the final disposition, if there has been a final disposition (page 32607). Counsel for the Director included Table V in his Argument without filing an affidavit.

At page 75 of his Argument, the Director states that ''lack of information'' has impaired the Department's ability to investigate. Mr. Szyc testified otherwise. (See Transcript Volume 36, pages 7756-76, 7781-96, 7803-05, 7809-11, 7817-23, 7831-32, 7837-43 and 7845-47.)

3. *The National Energy Board concluded that excessive prices were being paid by Canadian refiners for their imported crude oil*

The Director's references to the N.E.B. report are taken out of context. Taken as a whole, the report represents the conclusion by the National Energy Board that the Canadian petroleum industry was operating efficiently, but that Canadian refiners should be encouraged in every way possible in their efforts to secure lower prices from their suppliers. Although the Board calculated a price difference based on the information available to it, it was obviously satisfied that the difference did not represent anti-competitive behaviour, or excessive crude oil costs for Canadians. The Board was satisfied that it was not necessary to bring the subject to the attention of the Minister of Energy for action. The Board concluded that any overcharge would have been no more than approximately 10¢ a barrel. The Director presents that evidence in his Argument as though it is a conclusion that a rip-off had occurred. [See Transcript Volume 75, pages 14346-47, Volume 76, pages 14594-603 (Texaco witnesses) and Volume 71, pages 13376-78 and 13401-03 (Scotchmer).]

The larger question is why, when preparing the Green Books and preparing the Argument, the Director did not seek the assistance of unbiased government officials such as those responsible for administering Canada's energy policy.

4. *The Oil Import Compensation Program encourages multinational oil companies to send their highest cost crude oil to Canada and enables them to coordinate their import prices*[4]

The Director's submission is a complete distortion and misunderstanding of the evidence and the program. An oil producer cannot increase the compensation its Canadian affiliate receives by delivering high cost crudes to Canada and low cost crudes elsewhere. The amount of compensation does not depend on the actual costs of the importer. It is determined on the basis of industry averages. Texaco Canada hopes that a government department will respond to this attack on government administration.

5. *Canadian refiners were under financial constraints because of excessive crude oil prices*

The premise of the Director's argument is wrong. In any event, there is no evidence that Texaco Canada had difficulty in proceeding with justified major investments. During the period under review, a new and expensive refinery was constructed at Nanticoke, Ontario, with the financial support of the majority shareholder.

6. *Canadian refiners overstated the significance of security of supply*

This issue and the related one of the relationship between Texaco Canada and its majority shareholder were dealt with extensively in the evidence. Those pieces of evidence selected by the Director are not representative of the evidence as a whole.

Texaco Canada obtained benefits including security of supply from its special status as an affiliate of Texaco Inc. The Director has ignored other benefits that were discussed in some detail, including access to a variety of crude oils on a world-wide basis, access to a world-scale tanker fleet, the use of insignia and product brand names which are easily recognized by motorists visiting or touring Canada, the reciprocal use, for the convenience of its customers, of the Texaco Travel Card at retail outlets throughout the United States and Canada, access to certain refining processes and access to special expertise of Texaco Inc. in a variety of areas. (See Texaco's International Submission, Volume A, pages 13-16.)

C. International Remedies

In Volume 5 the Director suggests remedies without making his proposals clear.

At page 3 of the Conclusion, there is an argument that the alleged excessive costs warrant ''serious public policy intervention''. If that argument is clarified, Texaco Canada will respond, but it is difficult to comment on it in its current vague form. At page 5 of the conclusion, the Director indicates that he ''will urge the Commission to consider legislation'' with respect to allowance of crude costs for compensation and tax purposes. When he makes that submission, Texaco Canada will answer. It is not clear what further evidence or further argument the Director proposes to make in this sector of the Inquiry. When that is made clear, Texaco Canada will present its final position.

VI. CONCLUSION

1. Texaco Canada did not, as alleged in the Green Books, buy crude oil at prices in excess of fair market value, and retail prices of petroleum products were not kept artificially high by reason of such excess costs.

2. This Commission should reject the suggestion of some of the Director's witnesses that the fairness of prices paid by Texaco Canada should be based on the cost of production, rather than on prices asked and paid on world markets.

3. This Commission should reject the allegation that Canada's National Oil Policy was adopted to serve the interests of Ontario refiners intent on exploiting Canadian consumers.

4. No justification has been tendered for the suggestion that petroleum companies with multinational connections should be subject to rules different from those governing other large Canadian businesses.

NOTES TO PART ONE

1. The oral evidence and documents are discussed *infra,* page 6.

2. The scattered evidence of particular low price transactions cited by the Director in his Argument is dealt with *infra,* pages 11-12.

3. In this assertion, the Director has misstated the relevant dates. It is clear from the documents that the information was provided by the National Energy Board in 1970 and refers to 1968 crude oil costs.

4. The Director made a similar assertion in his statement of evidence entitled ''Crude Oil Transfers: 1974-1981'' (Exhibit I-80, page 34). That assertion was qualified by the statement that ''It is difficult to test this proposition using available data.'' During cross-examination of the Director's witnesses by counsel for Texaco Canada, Mr. Brant was unable to explain how the program operated to divert high cost crudes to Canada. (See Transcript Volume 67, pages 12676-12681.)

PART TWO

RELATIONS AMONG REFINERS

I. INTRODUCTION

The authors of the Green Books, the Director's witnesses and the Director's Argument allege that arrangements among refiners stifle competition and should be subject to government regulation. Because the three discussions present divergent justifications and remedies, they must be addressed separately.

II. RESPONSE TO THE GREEN BOOKS

A. Green Book Allegations

Volume V of the Green Books contains allegations of anti-competitive behaviour involving Texaco Canada and its refiner-marketer competitors. For competition purposes, the substance of those allegations can be broken down as follows:

(a) Canadian refiners did not seek to increase sales of petroleum products by reducing prices.

(b) Canadian refiners used disciplinary measures among themselves and against others in order to punish marketers who attempted to compete by reducing prices.

(c) Canadian refiners acted together to limit supplies to resellers; they discriminated against resellers that were price cutters; they discriminated against resellers that did not have the ability or interest to build a refinery.

(d) Canadian refiners discouraged entry into refining by offering to supply petroleum products at attractive prices to companies that otherwise seemed likely to build a new refinery.

(e) Canadian refiners deliberately exchanged sensitive competitive information in order to reduce competition.

Presumably to remedy these alleged competitive problems, the Green Books make the following recommendation:

> Recommendation #6:
>
> legislation be enacted requiring that all refiners operating in Canada obtain approval of the National Energy Board for all refinery supply agreements affecting inter-provincial and international trade and exchange. Before approving such agreements the Board must consult with the Minister of Consumer and Corporate Affairs as to the likely effect the agreements may have on competition.
>
> (Green Books, Volume 1, page 10)

B. Texaco Canada's Answer

Texaco Canada presented a panel of knowledgeable and informed witnesses who explained the policies and activities of the company during the period under review. Texaco Canada submitted a detailed brief and undertook to respond to every request for information by the Commission or any designated party. Texaco Canada's evidence demonstrated that during the years under review in Volume V of the Green Books:

(a) Texaco Canada competed vigorously against all its competitors in all markets. It sought to gain and hold customers and to maintain and increase its share of market for petroleum products. It competed on the basis of price, quality, service, image and its marketing expertise.

(b) Texaco Canada did not control or attempt to control the marketing practices of any of its competitors.

(c) Texaco Canada attempted to build its share of market by competing for all classes of trade; it made vigorous and continuing efforts to increase its sales to independent marketers and resellers. The evidence demonstrated that Texaco Canada sold to large independent marketers (including Canadian Tire Corporation, Limited) that were known to have built their markets through low pricing policies. Texaco Canada did not attempt to direct the pricing policies of its customers.

(d) Information necessary to complete commercial transactions was exchanged between Texaco Canada and those companies with which it dealt. Texaco Canada did not deliberately exchange or disclose commercially sensitive information beyond what was essential to the commercial transaction.

Texaco Canada's witnesses were knowledgeable participants in Texaco Canada's refining and marketing decisions during the years under investigation. As astute observers of the behaviour of other refiner-marketers, they were witnesses that the Director, through cross-examination, could and should have relied upon to develop factual support for his allegations. Yet the Director made no attempt to pursue this seemingly obvious avenue of investigation. In particular,

- The Texaco witnesses were not confronted with the allegation, or indeed any evidence, that Texaco Canada deliberately refrained from competing by price or otherwise in any market.
- The Texaco witnesses were not confronted with the allegation, or indeed any evidence, that Texaco Canada attempted to ''discipline'' any refiner or marketer.
- The Texaco witnesses were not confronted with the allegation, or indeed any evidence, that Texaco Canada refused to sell to resellers because of a concern that the resellers would cut prices, or that Texaco Canada refused to sell to resellers who did not own or have the ability to build a refinery, or that Texaco Canada offered supply to resellers in order to discourage any reseller from building a refinery.
- The Texaco witnesses were not confronted with any allegation, any evidence or any suggestion that the company unnecessarily disclosed or exchanged confidential information with refiner competitors.

The Director has had many opportunities since this hearing began to question witnesses in order to uncover factual support for the allegations of monopolistic behaviour and restrictive practices found in Volume V. The Director has refrained from questions in those areas, not only when questioning witnesses from major petroleum companies, but also when questioning smaller refiners and the larger resellers and marketing chains that, if the Director's allegations were correct, would have been the victims of the alleged anti-competitive behaviour.

For example, witnesses testified on behalf of Federated Co-operatives Limited (''Co-op''). Co-op developed its marketing network during the period under review and, therefore, if the Director's allegations were correct, would presumably have been a victim. Yet, the Director made no effort to establish the allegations through the Co-op witnesses. It was left to Commission counsel to question the Co-op witnesses about the Director's allegations. When he did, the witnesses denied knowledge of the restrictive activity alleged in the Green Books. (See Transcript Volume 172, pages 30789-94.)

The Director did not even use his own witnesses to support his allegations. The Director's panel of witnesses apparently deliberately avoided an analysis of the allegations in Volume V of the Green Books. In fact, to the extent that the members of that panel had knowledge of the industry, they failed to support the Green Book allegations. (See Transcript Volume 109, pages 20664-65.)

If the allegations in Volume V are not accurate, they should have been withdrawn long ago. If they are, or even might be, they ought to be examined and, if possible, proved for the benefit of the government and the Canadian public. They are scandalous allegations of anti-competitive, improper and perhaps even illegal behaviour. It is irresponsible of the Director to make the allegations, to permit them to stand and then in large measure to ignore them in the evidentiary phase of this proceeding.

In the face of the evidence, no weight should be given to the allegations of the Director in Volume V, which are supported only by highly selective and misleading quotations from documents that were seized and which were contradicted by the evidence received at the hearings.

III. RESPONSE TO THE DIRECTOR'S WITNESSES

During the hearings, the Director's witnesses presented opinions and remedies that departed dramatically from those contained in the Green Books. Gone, though not withdrawn, were the scandalous allegations of anti-competitive, improper and perhaps even illegal behaviour. In their place was an attack on lawful business practices that the Director's witnesses themselves conceded result in economic benefits. The Director's new analysis is not based on a detailed investigation of the industry, on a knowledgeable analysis of factors contributing to efficiency or on an analysis of the actual exchange agreements in place in the industry. The witnesses did not attempt a detailed investigation of competition or the actual market impact of the arrangements under review. They also did not attempt to analyze the cost or practical consequences of their conclusions. However, the Director's new analysis is based almost exclusively on the theories and arguments of his witnesses.

The concern of the Director's witnesses as reflected in their formal witness statement was not monopolistic practices, collusive behaviour or deliberately restrictive anti-competitive practices. Rather, their principal concern was the theoretical infirmities of reciprocal, long term and negotiated contracts for petroleum products. Recognizing that such contracts result in some benefits, the statement nevertheless concluded that they reduce competition for the following reasons:

1. There is an exchange of confidential information among the limited group of refiner participants.
2. Reciprocal and long term agreements limit product availability to resellers and independent marketers.
3. Reciprocal and long term agreements have the result of entrenching market shares.
4. Arrangements involving barter or trade rather than purchase and sale are less efficient and, therefore, less socially desirable because they result in higher product costs, distorted investment decisions and higher search and contract costs. Those costs will likely be reflected in higher prices to consumers.

The statement recognized that the economic savings attributable to refinery exchanges ranged from 10% to 18% of the cost of manufacturing and distributing gasoline and distillate (excluding crude oil costs and taxes). The statement did not attempt to estimate or quantify any offsetting inefficiencies or unnecessary costs which allegedly result from existing arrangements. Nevertheless, concluding that the benefits of reciprocal, long term and negotiated contracts were outweighed by such unquantified costs, the statement recommended that, with respect to petroleum products:

1. All reciprocal agreements between any market participants be prohibited.
2. All agreements of purchase and sale for longer than two years be prohibited.
3. All agreements of purchase and sale for longer than 90 days be subject to public tender.
4. All regulatory barriers to import and export be reduced.

The Director's counsel and the panel presented these recommendations in substitution for Recommendation #6 in the Green Books. (See Exhibit R-2.)

These recommendations did not survive the witnesses' testimony. The recommendations contained in the witness statement would have dramatically interfered with relationships between refiners and resellers and indeed relationships entirely between resellers themselves. They would also have prevented commercial purchasers of large quantities of petroleum products from securing supply by long term agreement even for their own use. During the course of its evidence, the panel substantially revised its position in recognition of some of these difficulties. Moreover, the panel members disagreed among themselves over the meaning of the recommendations in the statement (see, *e.g.*, Transcript Volume 106, pages 20138-39) and modified their recommendations to produce agreement. Accordingly, Texaco Canada's submissions that follow will be directed to the recommendations as amended.

The amended recommendations as finally settled by the witnesses appear to be the following:

1. All reciprocal agreements between refiners be prohibited, except for reciprocal agreements intended to respond to what the refiners define as emergencies, provided that such emergency agreements do not last more than 90 days.
2. All agreements of purchase and sale between refiners for longer than two years be prohibited.
3. All agreements of purchase and sale between refiners for longer than 90 days be subject to public tender.
4. All regulatory barriers to import and export be removed.

These recommendations were intended to remedy what was identified as an important competitive concern. In the opinion of the witnesses, reciprocal and long term agreements between refiners exclude from the general market the product that is subject to the arrangement. The Director's witnesses argued that, in principle and based on general economic theory, contracts of sale in an open and public market are more likely to produce price competition than private arrangements and that price competition benefits the public.

It is most important to remember that the concerns and recommendations were <u>not</u> being put forward to deal with findings of improper exercise of ''market power'' at the refining level. Competition among refiners is obviously vigorous and occasionally extreme. Independent resellers (among others) have benefited from this competition, especially during price wars, while refiners have had to bear the full burden of their refinery costs. The Director's witnesses did not contend otherwise, and they presented no evidence of restrictive or monopolistic practices at the refinery level of this industry.

Before addressing the panel's concerns, we review the business reasons that resulted in the current practices. All refiners who testified were of the view that these arrangements were not only cost efficient to them, but beneficial to the public. The evidence discloses the following benefits from reciprocal and long term arrangements:

1. A refiner is able to compete more effectively when product is received at or close to its refinery cost in areas in which it has no refinery. Illustrative is the arrangement that Texaco Canada recently concluded with Gulf Canada, whereby Texaco Canada will be acquiring petroleum products at lower cost from the Gulf refinery in Edmonton than by continuing operations at its own smaller and relatively less efficient Edmonton refinery. In effect, the arrangement allows Texaco Canada to close its Edmonton refinery and obtain product at lower cost in Edmonton under a secure arrangement with Gulf. Texaco Canada's lower product cost will make it a stronger competitor in Western Canada. Moreover, the average efficiency of Canadian refineries is increased. The evidence enumerates many other instances in which refiner-marketers have been able to compete in local markets without owning a local refinery based on the security of reciprocal and long term agreements.
2. Refiners can plan production and capacity in both the short and long run based on the security of reciprocal and long term arrangements. Without that security, supply disruptions and uncertainties would contribute to higher cost and eventually to higher petroleum product prices.

3. Security of supply is of great importance in justifying and supporting capital investment. If there is a significant risk of refinery or marketing interruption, it will be more difficult to raise capital. Prohibiting reciprocal and long term arrangements would create that risk.

Canadian refiners have invested substantially and, in recent times, have been struggling to maintain financial viability. The witnesses' revised proposals, because they apply only to refiners and not to other market participants, would in effect punish refiners simply because they are the source of supply of petroleum products. What logic or fairness can support the suggestion that, for example, Turbo Resources Limited ("Turbo") should forfeit the cost efficiencies of reciprocal and long term agreements it enjoyed as a marketer simply because it invested in a refinery? Investment decisions have been made in the recent past by major petroleum companies based on the laws then and now in place. Unless those companies have abused their market power, as they have not, what justification is there for changing the rules? Why should companies who have invested large sums to obtain the security of supply that comes from owning a refinery to supply it's outlets (both directly and through exchanges) be deprived of that security for no substantial reason? Such capricious interference with business affairs, based on nothing more than theory, risks long term damage to the investment climate in Canada.

Canada's major petroleum companies could probably survive the witnesses' revised recommendations, though at significant cost to themselves and to the Canadian public. But there are other petroleum companies in Canada as well. It is apparent that the refineries most vulnerable to short and long term financial disaster as a result of the Director's proposals are owned by the smaller petroleum companies.

Public concern has been expressed about the extent to which refineries have already been closed in Canada. Before implementing any recommendations, one must be certain of the consequences. Will they cause more closures? Will there be a shortage of capacity in some parts of Canada because of the closure of a refinery resulting from the lack of assurance of a market supported by exchange? Will the efficiency of the Canadian petroleum industry be impaired? The Director's panel acknowledged that it had not attempted a detailed analysis of these complicated questions. Nevertheless, they offered the opinion that economic detriment was unlikely. Surely, the magnitude of the risk calls for sophisticated investigation and considerable certainty.

We now propose to address the principal arguments presented by the Director's witnesses.

1. Current practices result in an exchange of confidential information between refinery owners to the detriment of competition

No evidence was offered that any information was exchanged beyond that which was required to conclude the agreement being negotiated. A marketer keeps his costs confidential because knowledge of those costs could be used by a competitor to its advantage. Under the prevailing practice of obtaining products through reciprocal agreements, the parties involved will not be aware of each other's costs. Each obtains product at various locations at its own costs, plus any differential payments made pursuant to the agreements. Thus, unlike the situation that exists under a purchase and sale agreement where the seller obviously knows the

purchaser's costs because he knows what the purchaser paid for the product, a party to an exchange agreement does not learn the other party's costs. As transactions are now carried out, access to any information that is exchanged is restricted to the immediate parties to the agreement. As long as that information is not shared with the marketplace generally, the effects of this limited and necessary disclosure are minimal.

Moreover, the information now necessarily disclosed in this way is of limited competitive significance. The Director's panel seems to overlook the fact that refiners generally have more than one source of acquired product. They may enter into agreements for purchase or exchange with other refiners or local suppliers and, in some areas, they may import product manufactured elsewhere. Information disclosed in connection with any individual arrangement therefore does not reveal a complete picture of the refiner's costs.

The panel believes that it would be in the public interest for information now kept confidential by the parties to an exchange or sale to be publicly disclosed. Such public disclosure of virtually all transactions could lead to serious competition problems. When competitors are unaware of the actual costs of other significant market participants, parallel marketing behaviour is difficult and unlikely. But competitive actions and responses can be coordinated when knowledge of a competitor's circumstances allows its competitive reactions to be predicted with a high degree of confidence. The panel recognizes the competitive problems resulting from broad dissemination of such information. It fails to recognize that its proposal increases the danger.

The Commission heard evidence in confidence as to the precise financial terms whereby Texaco Canada will be acquiring petroleum products from Gulf Canada to support its markets in Western Canada. It is just such confidential information that the Director's recommendation would make public. Surely, competition is not benefited by requiring that that information be circulated to the public at large, including Texaco Canada's other major competitors.

The panel's concern is not based on evidence of anti-competitive behaviour resulting from information exchanged. The concern appears to be founded on theoretical analysis by people who do not have a detailed knowledge of the activities and practices prevalent in the refining industry in Canada today.

2. *The result of reciprocal agreements is to maintain inefficient and costly refineries in operation in Canada*

This proposition was not proven and is not true. One possible result of prohibiting reciprocal and long term agreements would be the closing of refineries that could not support an adequate utilization rate through local markets and sales alone. The evidence has demonstrated that refineries such as those owned by Turbo and Co-op rely significantly on reciprocal arrangements that allow markets far from the refinery to contribute to capacity utilization. Such refineries are the ones threatened by the proposal. Failure to bid successfully for volumes previously obtained through exchanges could render those refineries physically or economically inoperable.

The panel did not show that it is socially desirable to force those refineries out of business. There was no real analysis of their relative efficiency and their impact, if any, on product prices. Nevertheless, it must be recognized that their presence in the Canadian market provides an additional element of competition. In advancing a proposal that risks putting those

refineries out of business, the panel relied solely on its theoretical conclusion that reciprocal agreements serve to preserve inefficient refineries.

This argument is all the more remarkable when we recognize that a major concern in the Green Books is concentration of refining capacity in the hands of the major oil companies. It seems anomalous that the Director would present a proposal that is so threatening to several of the refineries in Canada that are not controlled by multinational oil companies.

3. *Reciprocal arrangements and long term agreements result in high search and contract costs*

This assertion was not supported. It was an argument based on a review of documents, an off-the-record discussion with market participants and pure theory. No effort was made to quantify the alleged extra costs and to determine whether that cost was of an amount that is in any sense material to the market participants, much less to the prices of petroleum products. Texaco Canada, of course, concedes that reciprocal and long term arrangements cannot be negotiated without cost. But all transactions, including purchases and sales, entail costs and the panel has not shown that the costs would be any less under its proposal.

4. *Reciprocal arrangements and long term agreements entrench market shares*

No evidence was offered of any restrictive agreements imposing any limits on the marketing flexibility of a refiner receiving product by way of exchange or purchase. Moreover, it is wrong to assume, as the panel apparently did, that exchanges or long term agreements prevent a marketer from increasing its market shares, either locally or nationally. The evidence shows that refiners have more than one source of supply in markets supported by exchanges. Moreover, so long as excess capacity exists, a refiner can supply an exchange partner without necessarily cutting back its other sales.

5. *Reciprocal and long term agreements between refiners give priority of supply to refiner-marketers*

In one trivial sense, the assertion that reciprocal and long term agreements between refiners give priority of supply to refiner-marketers is obviously true. The product that Refiner A provides to Refiner B cannot simultaneously be provided to anyone else. The truth of the assertion in this sense is simplistic and trivial, because Refiner B may, and often does, sell the product it receives from Refiner A to other marketers, and because Refiner A will usually have sufficient quantities of product to sell to any other purchasers who want to buy from him.

The panel's failure to understand that product obtained through a refinery exchange may be resold to other marketers underlies its suggestion that exchanges and long term agreements deprive independents of product. In fact, the record shows that exchanged product is not unavailable to independents. For example, Robert Brodie of Merit Oil testified that he obtained product from Texaco Canada in the early 1960's in British Columbia, even though Texaco Canada received this product under an exchange agreement with Shell, and even though Shell had refused to supply Merit directly. (See Transcript Volume 49, pages 9826-27.)

The suggestion also rested on the panel's double counting of product supply. The witnesses conceded that such double counting may have occurred, and Texaco Canada provided an analysis showing that it had in fact occurred. (Reference can be made to Tab 5 of Texaco Canada's Refining Undertakings, Exhibit R-122, a copy of which is included as Appendix III.)

Reciprocal and long term agreements between refiners also may give priority of supply to refiner-marketers in the sense that refiners sometimes prefer such arrangements to other arrangements. But this preference, where it exists, rests on sound business reasons and leads to beneficial economic results not only for the refiners, but also for Canadians. The evidence of all refinery witnesses emphasized the importance of secured contracts of delivery or sale to support efficient refinery utilization and security of supply to support marketing investment. Reciprocal and long term arrangements represent just such contracts for both parties. The owner of a refinery, through exchanges, can confidently enter and hold markets in any part of Canada in which it can find an exchange partner.

Obviously, marketing competitors that do not own refineries would like the same security, but they cannot offer the same security in return. Moreover, the panel's claim of ''priority'' cannot justify any of its recommendations unless it can be shown that this priority means that other marketers are deprived of supply. The evidence refutes any such suggestion.

Charts I-A to I-E of Texaco Canada's submission entitled ''The Refining and Marketing of Petroleum Products in Canada'', Exhibit R-94, (''Texaco's Refining and Marketing Submission'') indicate that refining capacity exceeded crude runs in Canada throughout the entire post-war period. Surplus refining capacity prevailed through extended periods on a regional basis. This evidence refutes any allegation that exchange agreements ''dried-up'' the source of supplies for independents to penetrate the market.

Indeed, the evidence of the independent marketers themselves was that entry into the marketing of petroleum products was always relatively easy and that for virtually the entire period under review, there was an abundant supply of all products available to resellers at attractive prices. Much of the product refiners had available for sale to resellers was obtained through exchanges with other refiners.

6. *Economic analysis demonstrates that industry participants, and the public, would benefit from the recommendations*

The economic analysis presented by the panel, though of questionable validity, demonstrated the benefits of inter-refiner transactions. Their economic analysis did not demonstrate that these benefits would remain following adoption of the panel's recommendations.

The panel's conclusion that the public and the industry would benefit from the recommendations was not based on expert knowledge and investigation of the economics of the refining industry. Thus the suggestion that it might be feasible to temporarily close refineries when sales are lost at public auction is not consistent with the refinery evidence this Commission has heard. Nothing more than speculation supports the suggestion that the recommendations would, in the long run, be more cost efficient and would not, as the industry witnesses suggest, result in increased product prices and higher barriers to entry in both refining and marketing.

Industry witnesses testified that a probable result of adopting the recommendations would be to cause refineries to transport, at substantial cost, product that is now exchanged. The panel disagreed, but it did not present an economic analysis to indicate the extent to which it would be financially attractive for a refiner to haul products in order to achieve refinery utilization gains, rather than acquire product in distant markets if exchanges were unlawful. The panel's conclusion rests merely on theories and not on carefully researched and factually based assumptions.

The panel's recommendations are based on a fundamental misconception of the competitive forces in the marketplace. The panel would restrict refiners in order to assure supplies to independent marketers, who allegedly (at least at one time) had lower marketing costs. Yet the opportunity for efficiency and cost saving in marketing reflects itself in a very small percentage of the total price of petroleum products. Resellers and independents cannot compete effectively in today's market unless they are supported by the wholesale pricing practices and policies of refiners. Price levels, and indeed, price fluctuations, are primarily influenced by the competition that exists among refiners. The vigorous price competition that the most casual observer can see in today's marketplace is almost entirely a product of vigorous competition among refiners. This competition should not be restricted in an unnecessary attempt to encourage additional competition at the marketing level, which is already vigorously competitive.

Finally, and entirely apart from its other recommendations, the panel recommended sweeping changes in the relationship between Canada and world petroleum markets. No adequate research or analysis was concluded to permit this Commission to consider the full implications of the proposal that barriers to imports and exports be removed. The implications of that recommendation are enormous and require detailed consideration and input from other bodies including the National Energy Board and the Government of Canada. The competitive impact of such suggestions cannot be looked at in isolation from Canada's economic and political policies. Texaco Canada supports competition, but does not favour precipitous action and dramatic change that could have unforeseen and seriously detrimental consequences to it and the country as a whole.

IV. RESPONSE TO THE DIRECTOR'S NEW ARGUMENT

In his final Argument, the Director proposes dramatically different remedies designed to deal with what he sees to be competitive problems resulting from reciprocal and long term agreements. He also makes a number of new arguments. This section of Texaco Canada's response deals with those new arguments.

He identifies the following allegedly anti-competitive effects:

- The agreements permit coordinated industry expansion and control of existing capacity.
- The agreements have caused increased concentration in the refining industry.
- The agreements limit the access of resellers to product supplies.
- The agreements restrain competition by entrenching market shares.
- The agreements support inefficient refiners.

With respect to the first point listed above, the Director's submission raises two issues:

- Is the maintenance of excess capacity desirable?
- Recognizing that agreements that unduly limit competition by manipulation of capacity and supply are undesirable and illegal, is there evidence of any such agreements?

A. Exchange Agreements and Excess Capacity

While the Green Books criticize refinery exchange agreements, they recognize that such agreements serve to "avoid duplication of refinery facilities and overcapacity" and, therefore, that "exchanges could facilitate optimal investment programs." (Green Books, Volume V, page 47.) In the final Argument, the Director for the first time seems to be suggesting that continuing excess capacity is desirable because its presence will likely depress the market price of petroleum products.

It is obvious that because of refinery exchange agreements, some refiners have been able to become more efficient by closing less efficient refineries while still competing across Canada. A result of the independent decisions of the owners of several refineries has been to reduce excess capacity in the industry. The Director now seems to suggest that that result is undesirable.

This is economic nonsense. Excess capacity represents a costly misallocation of resources. It causes high production costs and an inefficient use of resources, a result which is bad for refiners, bad for the petroleum industry, bad for consumers and bad for Canada.

Texaco Canada submits that the Director's support for excess capacity can be understood only as the result of a narrow focus on the relation between excess capacity and prices during the period excess capacity exists. The Director apparently believes that excess capacity is good because it keeps prices down, forcing refiners to set prices at a level where they are recovering little more than their short run marginal costs and below the level necessary to cover their full costs, including a return on investment.

Even an elementary knowledge of economics demonstrates that artificial stimulation of excess capacity cannot possibly be a sensible goal for public policy. If it were, it would follow that the Canadian government should encourage the construction of more refining capacity, perhaps through tax subsidies, even though there is not enough demand to fill the refineries that now exist. That conclusion is absurd.

Efficiency in the long run depends on achieving the right level of investment and capacity. The price system assures this result by offering investors high returns in times of shortages and low returns in times of excess capacity. Thus, the low prices that accompany excess capacity are economically useful not because low prices are always good and high prices are always bad. They are socially beneficial only insofar as they provide a signal that leads to adjustments in the prior allocation of resources. In short, excess capacity, and the lower prices that accompany it, are valuable in the short term as a way of encouraging a shift of resources away from the areas of excess capacity and toward the areas where shortages exist. If artificially maintained over a long period of time, excess capacity will result in a serious waste of valuable resources.

It is virtually impossible for a refiner to adjust capacity precisely to demand, and perfect efficiency is therefore difficult to achieve. This is because capacity must be added or subtracted in relatively large increments. Exchange agreements help overcome these difficulties.

In periods of expansion, refiners construct new facilities in the expectation of earning a profit. Because building a new refinery of efficient scale necessarily expands capacity by a significant amount, companies risk not being able to recover their full investment. If the added capacity is significantly in excess of immediate requirements, short run marginal cost will be below full costs, and prices at or near marginal cost will not generate a sufficient return on invested capital. This risk is greater if competing companies add refinery capacity at roughly the same time; the added capacity will surely be in excess of need. Facing that possibility, a company may choose not to invest in new facilities and capacity needed for the efficient production of needed products would be unavailable. If, on the other hand, several companies invest in duplicate facilities, and significant excess capacity is added, the investment would be wasteful, refineries will operate below their efficient operating levels and investors will not receive a reasonable return. Exchange agreements overcome this problem to some extent by reducing the likelihood that any added capacity will be substantially in excess of demand.

Similarly, in times of declining demand, short run marginal cost is likely to be significantly below full costs precisely because substantial excess capacity already exists. To survive, companies must be able to reduce their capacity, thus increasing their efficiency of production. The risk in shutting refineries to reduce capacity is that there might be insufficient product available to meet marketing needs. Exchange agreements reduce that risk by assuring a refiner who is considering closing unneeded facilities that he will be able to supply his customers through an exchange partner.

In the long run, therefore, excess capacity is wasteful and inefficient. Encouraging expansion in times of excess capacity adds cost with no benefits and damages the economic viability of an industry upon which Canadian consumers depend. Preserving excess capacity in times of contraction preserves inefficiency and prevents needed restructuring of the industry.

The Director has ignored the economic realities and efficiencies in the marketplace. He has taken a short-sighted view of the market that suggests that continued excess capacity temporarily lowers prices to the consumer, albeit with continuing losses to refiners. He has ignored real efficiencies and long term costs.

B. Exchange Agreements and "Coordination"

Collusion among a dominant group of competitors to control or limit industry capacity in a manner that injures competition would be in restraint of trade. The evidence however, demonstrated that events affecting capacity and supply, including refinery openings and closings, were the result of independent decisions by market participants, including government-owned Petro-Canada. The Director made no effort to prove collusion or coordination in that regard.

The forty-five pages of the Director's refining argument (Director's Argument, Volume 2, pages 8-52) supposedly dealing with industry coordination are an elaboration of the proposition that refiners, in their attempts to avoid inefficiency and social waste, individually seek to eliminate unneeded capacity and use exchange agreements to reach that goal. These pages show nothing more than that refiners must talk to one another if they want to negotiate exchange agreements.

The first twenty-seven pages concern negotiations and transactions entered into by several oil companies, not including Texaco Canada, in the 1960's and early 1970's. Texaco Canada leaves discussion of these events to the companies directly concerned.

In the remaining pages, the Director turns to the refinery closures of the recent period. It is plain that the companies involved were seeking to avoid inefficiency and waste. This is pro-competitive, not anti-competitive.

A repeated theme of this discussion is that the companies implicitly or explicitly exchanged information, including most notably information concerning their plans for closing refineries. This is neither surprising nor disturbing. A company planning to close a large refinery and seeking to replace its marketing needs with secure product obtained from other refiners (whether by exchange or by straight purchase) can hardly hide its intention to close its refinery. Nothing but a refinery closure could possibly explain a newly-developed need for abnormally large quantities of product in locations served by the refinery to be closed, as testimony the Director quotes makes plain. (''It became apparent to me [that Texaco was going to close Strathcona] when they submitted the type of volumetrics that they would be interested in acquiring from Gulf in Edmonton . . .'', Director's Argument, Volume 2, pages 42-43, quoting testimony of Mr. Matsushita of Gulf, Transcript Volume 181, page 32278.) Exchange of information of this kind is a necessary incident to any transaction that is large relative to the size of the market.

Moreover, the Director fails to show that information exchanges of this kind or the transactions to which they are ancillary are anti-competitive. No one has suggested that any of the agreements under review contain commitments that in any way limit the refining capacity of any company. Under all of Texaco Canada's agreements, both parties to the transaction remain free to close refineries (provided they continue to supply volumes contracted for) or to open refineries (provided they continue to accept volumes contracted for). Both parties continue to exercise their own business judgment concerning the level of capacity desirable for themselves. Texaco Canada's exchange agreements represent mutually beneficial opportunities for Texaco Canada and its exchange partners and not collusive agreements concerning industry capacity.

These characteristics of exchange agreements are illustrated by Texaco Canada's recent agreement with Gulf, to which the Director makes reference. As the testimony of Texaco Canada's witnesses made clear, Texaco Canada's agreement to exchange products refined at Texaco's Halifax and Nanticoke refineries for products refined at Gulf's Montreal refinery did not ''freeze'' Texaco's available supplies in the Province of Quebec. Although Texaco Canada will be obtaining its Quebec requirements from Gulf (see Transcript Volume 180, pages 32202-04), that is not the only option open to it. For example, Texaco Canada's witnesses also testified that the company's decision to close its own Montreal refinery was not premised on the availability of an exchange agreement. Instead, the company assumed that it would supply its Quebec requirements from its own refineries by transporting products into the Province. (See Transcript Volume 119, pages 22423-28.) Since that option is still available, Texaco Canada's available supply in Quebec is not limited to the amount Gulf is willing to supply.

The Director has only demonstrated that Canadian refiners negotiated among themselves mutually beneficial agreements that permitted each party to become more efficient. What he has failed to show is that these agreements are anti-competitive or otherwise undesirable.

C. Exchange Agreements and "Concentration"

The Director's Argument rests on a seriously erroneous characterization of the competition issues raised by exchange agreements. The Director poses the issues in this way: "Increased concentration and the reduction in the number of refineries necessarily concerns those responsible for enforcing Canada's competition laws." (Director's Argument, Volume 2, page 1.) There are two problems with this approach. First, concentration has not increased; it has decreased. Second, the Director gives no reason why a change in the number of refineries, apart from any effect on concentration, ought to be of interest to those concerned with competition policy. These errors are considered below in turn.

The Director begins his discussion by noting that during the period analyzed in the Green Books, four petroleum companies accounted for close to 75% of Canada's refining capacity and, the Director continues, "control by the four largest refiners declined after 1973 . . ." (Director's Argument, Volume 2, page 1.) Where, then, is the increased concentration that should concern this Commission? The Director's answer is that, notwithstanding significant decreases over the last decade, concentration has increased in the last 14 months.

Look at the facts! However measured, the decline in concentration since the Green Book period has been substantial, and the increase over the last 14 months has been small. According to the Director's Table I, four companies which during the Green Book period had "close to 75%" of Canadian refining capacity had seen their share reduced to only 57% by 1981. The increase over the past 14 months, which the Director believes should concern this Commission, was an increase of two percentage points, to 59%, still 16 percentage points below concentration during the Green Book period.

But these figures are themselves contradicted by other data presented three pages further on in the Director's appendix, in Table III headed "SUMMARY OF REFINERIES IN CANADA."[1] Table III shows that the four largest refiners at the end of 1984 will *not* be the same four companies which during the Green Book period had close to 75% of refining capacity. The share held by the four companies which so concerned the Director in the Green Books — Imperial, Gulf, Shell and Texaco — is shown to be only 52% by the end of 1984, more than 20 percentage points less than in the Green Book period.

These tables show no significant increase in concentration at any time. Moreover, the overall decline in concentration, combined with important shifts in the relative size of refiners, are inconsistent with the Director's allegation that refinery exchange agreements, permitted the multinational oil companies to freeze markets and control competition in the refining industry. Large changes in shares of refining capacity do not suggest "control" or a non-competitive market.

Statistically, the Director is correct in alleging that the number of refineries has been reduced since the Green Book period. But unless each closed refinery was owned and operated by a completely independent competitive entity, the fact of a decline in the number of refineries is without competitive significance. The Director has provided no reason for

believing that the decline in the number of refineries, without a decline in the number of refiners, is at all relevant, and none can be found in the literature on competition policy. The only real economic significance of the decline in the number of refineries is that it offers graphic proof of the excess capacity and of the existence of economies of scale, economies that help justify the use of exchange agreements between refineries of efficient size.

True, there is an association between the decline in the number of refineries and an increase in the relative importance of exchange agreements. But the Director should not rely on the circular argument that the decline in the number of refineries is of competitive significance because of the increase in exchange agreements and that the increase in exchange agreements is of competitive significance because of the decline in the number of refineries. The Director must provide some independent basis to prove that exchange agreements are anti-competitive.

The Director dramatizes the issue by pointing to what he calculates as an increase in the proportion of gasoline production subject to exchange agreements in the period since 1981 (Director's Argument, Volume 2, page 3). Arguments that rely on such figures fail to come to terms with the fact that exchange petroleum products may be, and often are, subsequently sold to third parties, including independent resellers. Even if such figures had competitive significance, it would be necessary to rely on correct figures. While Texaco Canada cannot fully analyze the Director's data, because the Director relies on confidential information not available to it, access to the underlying data is not necessary in order to demonstrate that the Director's calculations are misleading.

At page 3 of his Argument on the refining sector, the Director states that the proportion of industry production that was exchanged among the four majors has increased from 33% to 57% between 1981 and 1983. He concludes:

> ''For the industry as a whole, the figure is a startling 63%.''

These figures are highly misleading. They erroneously calculate the increase since 1981 by relying on three improper assumptions.

The Director first assumes that ''[d]emand in 1984 (read production) is the same as in 1981.'' (Director's Argument, Volume 2, page 94.) But demand for gasoline in Canada fell in 1982 and in 1983, that trend is likely to continue, and there is in any event little reason to believe that 1984 will see a rebound to 1981 production levels. It therefore cannot be seriously contended that the Director's first assumption is correct. There was no need for all 1981 production from refineries closed after 1981 to be replaced by long term exchange agreements — and not all will be. Some such production will simply be lost to all refiners.

The Director's second assumption is that ''[a]ll production from closed refineries is replaced by long term exchange agreements [with three exceptions.]'' (Director's Argument, Volume 2, page 97.) This assumption is false for two reasons. First, because not all production from closed refineries will be replaced. Second, it is false because not all the production replaced will be replaced through exchange agreements. For example, Texaco Canada will be replacing production from its Edmonton refinery through a processing agreement. The Director is counting as volumes delivered under exchange agreements quantities of product that will actually be delivered by other means (processing agreements and sales).

The Director's third assumption is that ''[a]ll volume supplied on exchange agreements by the closed refinery is satisfied as before. That is, there are no changes in the prior exchange volumes among partners.'' (*Id.*) This assumption is also likely to be false for two reasons. First, since demand will be lower in 1984 than in 1981, volumes on exchange agreements are likely to be lower. Second, because of declining demand and the closing of refineries, some exchange agreements counted in the Director's original figures are likely to be cancelled. To the extent that this occurs, the Director's calculations are based on exchange agreements that no longer exist.

Even if all the Director's assumptions were valid, his calculations would be misleading because the methods used result in double counting. For example, assume that Refiner A, to meet its existing exchange agreement with Refiner B, must obtain product from Refiner C through exchange because Refiner A has closed his own local refinery. The Director's calculation counts the volume supplied twice, once when Refiner A obtains it from Refiner C, and once when Refiner B obtains it from Refiner A. This double counting renders the Director's figures meaningless as indications of the competitive significance of exchange agreements.

As illustrative of this problem in the Director's calculations, reference can again be made to Texaco Canada's recently concluded supply arrangements with Gulf. In the West, for example, Texaco Canada will continue to exchange products with Co-op and Petro-Canada. It will supply them with products that will be obtained from Gulf following the closure of Texaco Canada's Edmonton refinery later this year. Similarly, in Quebec, Texaco Canada will supply Ultramar, with which it has an existing exchange agreement, with products obtained from Gulf as part of a reciprocal processing arrangement involving Texaco Canada's Nanticoke and Gulf's Montreal refinery. These exchanged volumes would be counted twice according to the Director's method of calculation.

Events since the Green Book period have shown that the Green Book allegations concerning the anti-competitive effects of refinery exchange agreements were false. Reference to a trivial increase in concentration in a 14 month period, which in fact did not occur, and to a decline in the number of refineries, itself a wholly benign adjustment of capacity to new demand conditions, cannot justify these allegations.

D. Exchange Agreements and Supply to Independents

The Director asserts that as a result of exchange agreements among refiners, ''very little [product] was available for non-integrated companies.'' (Director's Argument, Volume 2, page 2.) This is the principal basis for the Director's concerns about exchange agreements. Nevertheless, the Director does not offer any evidence to support the assertion, and none can be found in the record of these proceedings.

The Director apparently thought he had evidence to support this proposition and that he had presented it. It is otherwise difficult to understand what significance the Director attached to his calculations purporting to show the proportion of production accounted for by exchanges. But aside from the Director's errors in calculation discussed above, these calculations prove nothing about the quantity of product available to independents.

The Director, like his panel of refining witnesses, makes an error of interpretation. He appears to assume that product a refiner obtains through exchange agreements may thereafter

be sold only through that refiner's vertically integrated distribution chain. But there is no basis for that assumption, and the record demonstrates that it is erroneous. (See, *e.g.*, Transcript Volume 49, pages 9826-27.) The evidence demonstrates that petroleum products have always been available for sale by Canadian refiners to independents who were willing to pay market prices.

E. Exchange Agreements and Entrenching of Market Shares

Conceding that "providing product to a competitor might . . . enable that competitor to compete more actively with the supplying refiner in areas where the purchaser of the product did not have a refinery," and that this aspect of supply agreements among refiners presents a "potential for new competition," the Director argues that "balanced reciprocity" prevents active competition from developing (Director's Argument, Volume 2, pages 53-54) and therefore that exchange agreements are anti-competitive.

The Director's misunderstanding here rests ultimately on his implicit assumption that refiners have an obligation to offer their competitors whatever quantity of product the competitors desire at any time. As Texaco Canada has previously demonstrated (see Texaco's Refining and Marketing Submission, pages 75-76), the notion that competition requires that refiners offer their competitors unlimited supply is nonsense. Quantity restrictions are reasonable ancillary restraints in any supply transaction whether by exchange or otherwise, and are contrary neither to sound competition policy nor to the public interest. "Balanced reciprocity" provisions are simply a form of quantity restriction.

The Director argues that these provisions are anti-competitive because they "ensure [] stability in market shares." (Director's Argument, Volume 2, page 54.) This language suggests that "balanced reciprocity" amounts to an agreement dividing markets, which would of course be anti-competitive. But balanced reciprocity agreements do not entrench market shares.

The sources of the Director's belief that exchanges of equal volumes stabilize market shares appear to be an incorrect factual assumption and an analysis founded on an algebraic error. In order to reach his conclusion, the Director must have assumed that a party who receives product under an exchange agreement has no other source of product, for otherwise the conclusion would be patently wrong. If a party to an exchange agreement is completely dependent on his exchange partner for product, the amount of product the partner supplies determines how much product the party can sell. But if the party can obtain product from another source, the amount obtained on exchange does not determine how much the party can sell, and the Director's conclusion does not follow.

Product is generally available directly from other refiners, from local resellers, and in some areas from foreign sources. It can also be transported from an exchange recipient's other refineries. Moreover, there is no provision in any current Texaco Canada exchange agreement that would prohibit a party to the agreement from obtaining product from other sources. It follows that exchange agreements, even balanced exchange agreements, simply provide a source of product without restricting the ability of the parties to the agreement to compete.

The Director's algebraic error is found in the Green Books and he has yet to correct it. In the Green Books, the Director made the same argument: balanced reciprocity "fixed the relative market shares in the sense that neither firm could expand in the territory of the other

and increase its share of both markets.'' (Green Books, Volume V, page 3). That statement is supported by a footnote containing some algebraic formulae. This algebra is wrong. (Texaco Canada demonstrates the error in Appendix IV to this Argument.) Correcting the algebra makes clear that this proposition, which necessarily relies on the incorrect assumption discussed above, is in general true only if both parties to the exchange agreement are operating their refineries at full capacity. (In today's market conditions, of course, propositions that hold true only when refiners operate at full capacity should not long trouble this Commission.) If the refineries are not operating at full capacity, relative market shares change when the amounts lifted under the exchange agreement change, even though the exchange agreement is ''balanced''.

Thus, the Director's argument concerning balanced reciprocity and stable market shares is wrong entirely apart from the misconception of competition policy upon which it rests. Balanced reciprocity does not fix relative market shares.

F. Exchange Agreements and Efficiency

The Director appears to recognize that reciprocal agreements, as they exist in the petroleum industry today, reduce transportation costs and increase refinery utilization (Director's Argument, Volume 2, page 73). The Director questions whether reciprocity is essential to achieve these efficiencies. The Director contends, ''the reciprocity element in fact introduces inefficiency.'' *(Id.)* Neither evidence nor theory supports the Director's contentions.

The Director's claim that reciprocity is not essential to the efficiencies that today result from exchange agreements rests on the assertions of the Director and his panel. Petroleum industry witnesses explained at some length that if refiners were prevented from entering into exchanges, they might engage in some costly hauling of product that they now avoid through exchanges. In testimony and in written submissions (See Texaco's Refining and Marketing Submission, pages 67-68), the witnesses analyzed the economic benefits of reciprocity, benefits that are not available through simple purchase and sale transactions. Because of these benefits, refiners would not fully replace exchanges by independent purchase and sale transactions. The Director does not believe this. But rather than address the industry arguments concerning the advantages of reciprocity and the likelihood that banning exchanges would lead to higher costs, the Director simply asserts the contrary. This Commission must choose between the reasoned analysis and real-life business judgments of the witnesses and the Director's wholly theoretical assertions.

The Director's contention that exchanges introduce inefficiency rests primarily on theoretical error. The error is to assume that the existence of reciprocal exchanges means that petroleum markets operate as a barter system. The Director says, ''[c]onditioning exchanges on reciprocity reduces the transaction to essentially a barter system.'' (Director's Argument, Volume 2, page 73.) While the inefficiency of pure barter systems is well known in economic theory, petroleum markets do not use the kind of ''barter'' system discussed in the economic texts.

In economic theory,[2] a barter economy is one in which there is no money, and nothing else performs the functions of money. *All* transactions consist *entirely* of the exchange of goods for goods. In such an economy, inefficiency results from the requirement of a ''double consistency of wants'', or what the Director calls ''coincident demand'' (Director's

Argument, Volume 2, page 73). This requirement means that trade can take place only if it is possible to find two parties each of whom can supply to the other precisely the goods that the other requires, neither wanting the goods for the purpose of further trade. Obviously such a requirement is difficult to satisfy, and therefore efficiency-enhancing trades may not occur.

There is no such requirement in Canadian petroleum markets. Many exchange transactions do have monetary elements; not just petroleum, but also money changes hands, in order to make the exchange equal. Even where money does not change hands, cash transactions (that is, sales of product) are always available as an alternative. Given that alternative, the parties freely choose a pure exchange; it is not a requirement. To the extent that exchange transactions can be characterized as barter, it is barter freely chosen, and not imposed by the system.

Because petroleum transactions do not require the double consistency of wants that makes a barter economy inefficient, the theoretical result that barter economies are inefficient does not apply to Canadian petroleum markets. Thus theory alone does not show exchange transactions to be inefficient. Evidence is necessary.

The Director has not bothered to provide such evidence. Instead, he relates the histories of the refineries at Taylor Flats and Regina. Neither shows that exchanges are inefficient or otherwise undesirable.

The Director's version of the Taylor Flats history is, in summary, that Pacific Petroleum built a refinery far from other refiners to use a low-cost feedstock; that despite Pacific's locational advantage and low cost feedstock, other refiners did not buy from Pacific, but continued to supply their outlets in the area from their own refineries; and that only after Pacific obtained retail outlets in other areas, would other refiners enter into exchanges with Pacific.

The Director concludes from this that the ''rules of the refining game in Canada'' are that ''[r]efiners do not buy unless the seller, in turn, agrees to buy on a reciprocal basis'' (Director's Argument, Volume 2, page 75). The Director implies that efficiency considerations should have led other refiners to buy from the monopoly supplier in Taylor Flats. Moreover, the Director asserts, it was inefficient for Pacific to become a competitor in areas remote from its refinery, because there were already too many retail outlets in those areas.

The evidence does not support the Director's analysis. Cost considerations are not as simple as the Director suggests. First, the Director's conclusions concerning the cost of supplying an area from other refineries is misleading. The Director suggests the alternative to buying from Pacific was hauling from Edmonton, 350 miles away. But in addition to ignoring the reality of supply from Vancouver, the Director apparently assumes, incorrectly, that retail outlets in the immediate vincinity of Taylor Flats, described as ''not much more than a wide place in the road'' (Director's Argument, Volume 2, page 74), were sufficient to absorb the output of the Taylor Flats refinery. In reality, of course, the market area in question was a large one, and the differences in distance for most of that area were smaller than the Director suggests. In addition, while the Director implicitly assumes that transportation cost increases proportionately as distance increases, for two of the forms of transportation used to supply the area in question (barge and rail), average cost per mile is decreased significantly as distance increased. That is, the incremental cost of additional distance is low. Thus the transportation cost advantage of product from Taylor Flats was significantly lower than the Director implies.

Second, the Director ignores the cost implications for other refiners of ceasing to supply their retail outlets from their own refineries. Were they to do so, they would necessarily reduce their refinery runs. As a result, their average costs of production would increase. It is this cost increase which the refiners would have had to balance against any transportation cost savings attributable to the locational advantages of Pacific at Taylor Flats.

Third, the Director does not refer to the price refiners would have had to pay for production from Taylor Flats. The Director seems to assume that consumers would have been advantaged if all competing petroleum retailers had been required to obtain their product from the local monopoly producer.

The Director's suggestion that it was inefficient for Pacific to enter gasoline retailing in areas remote from its refinery because there were already too many gasoline stations in these areas is unsupported by any credible evidence. The Director offers only a brief summary of a study presented to a provincial royal commission several years after the Taylor Flats refinery began to operate. Even if this survey of one hundred service stations in an unidentified area of British Columbia were reliable, the Director does not indicate the criteria according to which "Dr. Young" concluded that resources employed in gasoline marketing were excessive.

In sum, the Taylor Flats history is consistent with the conclusion that it was efficient for other refiners to continue to supply their retail outlets with their own production until they could be assured that purchases from Taylor Flats would not lead to inefficient use of their own refinery capacity.

The Director's analysis of the Co-Op refinery in Regina also does not support the conclusion that exchanges result in inefficiency. According to the Director, the Co-Op refinery is inefficient (as compared with other refineries capable of supplying the area) and it remains in operation only because of exchanges. But the Director has not shown that closing the Co-Op refinery would be economically desirable. Moreover, that refinery remains open not because the system of exchanges preserves it, but rather because its owners choose to keep it open.

The Director presumably considers it sensible for Co-Op to shut its refinery if it could buy product from other refiners at less than its own costs. The Director has not shown that Co-Op could do this even if the Co-Op's costs, properly analyzed, are higher than those of other refiners: other refiners would sell to Co-Op not at their costs, but rather at market prices. But even if Co-Op could do this, the fact that it does not, but rather continues to operate its refinery, suggests not that exchanges preserve inefficient refineries, but rather that the Co-Op owners for reasons best known to themselves prefer to keep their refinery operating. Even assuming that Co-Op could buy product more cheaply than it can produce it would not make the decision to continue production irrational if operating a refinery provides other benefits to the Co-Op for its members. It is simply not credible to suggest that Co-Op today could not close its refinery and obtain products from existing Canadian refiners. Accordingly, if as the Director suggests it is inefficient for Co-Op to continue production, that inefficiency should be laid at the door of the Co-Op, and not attributed to exchanges.

Finally, the Director attempts to show that exchanges are inefficient by citing the fact that exchanges cannot be negotiated without cost. But the Director has not even attempted to show that exchanges are more costly than other transactions to negotiate. Absent such

evidence (and Texaco Canada submits that there can be no such evidence), there is no basis for concluding that exchanges involve inefficiency in negotiations.

In sum, credible evidence that the Director has not refuted demonstrates that exchange transactions enhance the efficiency of the Canadian petroleum refining industry. Nothing but misapplied economic theory suggests that exchanges create inefficiency.

G. The Director's Refining Recommendations

In the Conclusion to his Argument, the Director promises to call further evidence regarding four proposals, which Texaco Canada assumes are intended by the Director to supplant his earlier recommendations. Texaco Canada is pleased that the Director will call further evidence because that may help clarify aspects of the proposals that Texaco Canada cannot now understand. In light of the Director's plans, the company will defer extended commentary on the proposals until the appropriate time, offering here only a few brief comments directed to each.

> 1. *"That all reciprocal exchange agreements between refiners in excess of 90 days be prohibited."*

Texaco Canada submits that this proposal lacks any support in the evidence, because the Director has failed to show that exchange agreements are undesirable on any ground. Moreover, credible, unrefuted evidence has shown that exchange agreements, particularly those in excess of 90 days, make an important contribution to the efficiency of Canadian refining and marketing. There is no basis for banning such agreements.

> 2. *"That refiners be required to deal with each other by separate and independent purchase and sale agreements obtaining prices for their products sold and purchased for all contracts in excess of 90 days."*

The Director's second proposal may even have broader implications. For example, this proposal may be interpreted as banning processing or throughput agreements, for such agreements represent dealings among refiners that are not purchase and sale agreements. Yet the Director's argument does not even purport to provide reasons for banning processing or throughput agreements of more than 90 days duration. The Director's latest answers to questions from Commission counsel only confuse the issue further; the Director now says that, notwithstanding the language of his proposals, they were intended to <u>include</u> processing agreements. (See Director's letter of March 13, 1984, page 17.) But processing agreements are not "separate and independent purchase and sale agreements," within the language of the proposal.

This proposal might also be interpreted as requiring that contracts for purchase and sale specify prices in dollars and cents, rather than providing a mechanism for determining prices, such as an inflation escalator clause or an adjustment for crude costs. Again, the Director's Argument does not purport to provide reasons for banning such provisions.

> 3. *"That all purchase and sale agreements exceeding two years in duration be reviewed by the Restrictive Trade Practices Commission or the National Energy Board to determine whether or not they are in the public interest taking into account their effects on competition."*

While the precise details of this proposal are obscure, it is clear that the Director is proposing to restrict the freedom of refiners (and perhaps others) to enter into transactions of longer than two years duration. Yet nothing in the Director's Argument purports to explain why any purchase and sale agreements exceeding two years might be objectionable. Indeed, while the Director does object to long term *exchange* agreements (though without explaining why), nowhere else in his Argument does he hint that there is anything objectionable at all about long term purchase and sale agreements. While all the Director's recommendations are without evidentiary support, this one lacks even rhetorical support.

The Director proposes governmental review of long term transactions but he fails to specify the criteria upon which such review would be based (beyond a vague reference to "the public interest"). Texaco Canada awaits with interest the evidence to come, which will surely include some suggestion of the criteria this Commission or the National Energy Board would apply.

> 4. *"That any existing exchange agreements be also subject to a review process of the type discussed."*

As the type of review process previously discussed is obscure, this proposal is also necessarily obscure. But there is here a perversity not found in the previous proposal. This fourth proposal can be read as suggesting that either the National Energy Board or this Commission invalidate existing exchange agreements if they are found not to meet the Director's undefined public interest standard. Existing exchange agreements were entered into in good faith, and there is no suggestion that they violate any existing law. In reliance on these agreements, companies have made investments, closed refineries and otherwise carried on their businesses lawfully. Can the Director seriously be proposing that these agreements be abrogated on the basis of nothing more than an *ex post facto* determination that they were not in the public interest? Texaco Canada submits that not even if the Director's allegations had been supported by evidence would there be any basis for this Commission to recommend action so disruptive of the Canadian economy.

V. CONCLUSION

Texaco Canada submits that the Commission should reach the following conclusions relating to the refining evidence:

1. The Green Book allegations that arrangements between refiners stifled competition and encouraged parallel anti-competitive behaviour are unproved and false.
2. Reciprocal arrangements of both long and short term save costs, encourage competition, and benefit the public.
3. Healthy and vigorous competition exists among Canadian refiners, resulting in efficiencies for the refiners and savings for Canadian consumers.

NOTES TO PART TWO

1. The tables contain inaccuracies which are not important to our basic submission.
2. See W.S. Jevans, *Money and the Mechanism of Exchange* (1875); Starr, ''The Structure of Exchange in Barter and Monetary Economics'', 86 *Quarterly Journal of Economics* 290 (1972).

PART THREE

MARKETING

I. INTRODUCTION

Volume VI of the Green Books details the Director's allegations of anti-competitive behaviour by Texaco Canada and its principal competitors during the years under review. The Director claims that his conclusions are based on information contained in the material that was seized from oil companies and are supported by studies and analyses conducted by the Director's staff. These hearings were intended to provide the Director an opportunity to prove his factual assertions by evidence, both written and oral, and to justify his economic analyses and conclusions by the sworn testimony of witnesses and professional analysts.

The Green Book allegations may be summarized as follows:

1. Texaco Canada and its refiner-marketer competitors acted collusively to prevent or lessen competition among gasoline marketers in Canada.
2. Texaco Canada and its refiner-marketer competitors attempted to control or eliminate independent gasoline marketers by making joint and harmonized use of monopolistic and predatory practices.
3. Texaco Canada and its refiner-marketer competitors acted together and collusively to maintain deliberately inefficient marketing systems to the detriment of independent marketers and the consuming public.

At the hearing, counsel for the Director filed a mass of material taken from the oil companies. He made no real effort to prove the factual assertions and conclusions in Volume VI. Most remarkable is the Director's failure to present the authors of the Green Books for examination. If the Director believes that the authors' factual assertions and economic analyses are justified, why is he not anxious to bring them forward to defend their position? If the allegations of predatory practice, discrimination and monopolistic behaviour are true, why have we not heard those allegations supported by the sworn testimony of market participants who suffered as a result?

Notwithstanding the fact that the Director did not attempt to prove the Green Book allegations, Texaco Canada filed written material and presented a panel of knowledgeable witnesses to disprove the allegations and explain Texaco Canada's marketing practices during the years under review. The witnesses explained the policies and practices of Texaco Canada as it competes to attract and keep customers. The facts and Texaco's analysis are detailed in Texaco's Refining and Marketing Submission. Texaco Canada witnesses responded to all questions directly, provided further information when requested and demonstrated the truth of Texaco Canada's submission. The evidence of the Texaco witnesses was not shaken in cross-examination. It was not contradicted by the evidence of other credible witnesses at this proceeding. Therefore, Volume VI of the Green Books should be rejected in its entirety.

It is apparent that the publication of, and public relations campaign accompanying the Green Books, were detrimental to the conduct of this Inquiry. The management and staff of the major oil companies in Canada understand the competitive nature of the oil industry and are proud of the role that their employers play in the marketplace of Canada. They were outraged that the Director would launch a public relations campaign to publicize allegations of

monopolistic behaviour and an alleged multi-billion dollar rip-off because they knew that the Director's allegations were false. The Director's irresponsible behaviour understandably provoked anger and a determination to prove the facts and demonstrate to the public and to the government that the circulation of the Green Books in these circumstances was against the public interest.

Because the Director's new Argument departs substantially from the Green Books, Texaco Canada does not propose to dwell further on the Green Books, except insofar as they are relevant to the arguments the Director is now making, which are analyzed in the sections that follow.

II. RESPONSE TO THE GREEN BOOKS

The sections of the Director's latest submission which relate to marketing contain a series of allegations concerning the practices of Canada's refiner-marketers over the past twenty-five years. To some extent, the submission repeats the errors contained in the Green Books; to some extent, it adds new material, equally unsupportable, about the post-Green Book period. In this section of its submission, Texaco Canada responds to the Director's marketing allegations.

A. The Director's Latest Submission Undermines His Green Book Arguments

The Green Books rest on three critical allegations: (1) that during the 1950's and 1960's, the branded full service networks of the so-called ''major'' refiner-marketers were ''inefficient''; (2) that refiner-marketers engaged in ''predatory'' behaviour to preserve their branded networks; and (3) that refiner-marketers consciously ''harmonized'' their predatory and anti-competitive behaviour against independent resellers to accomplish this purpose.

In his latest submission, the Director either abandons these allegations or presents evidence that further undermines their validity.

1. The Myth of ''Inefficiency''

In his latest submission, the Director repeatedly resorts to the Green Book assertion that the major refiner-marketers consciously maintained ''inefficient'' marketing networks during the 1950's and 1960's (Director's Argument, Volume 1, pages iii-iv; Volume 3, pages 1-2; Volume 5, pages 355-56; and Conclusion, page 9). As in the Green Books, however, he offers no factual support for this unlikely proposition.

The Director supports his ''inefficiency'' argument by presenting the unsupported theory that the multinational refiner-marketers maintained inefficient networks ''to find a home'' for the highly profitable crude that they produced and traded (Director's Argument, Volume 3, page 1). Even if this ''move-the-crude'' hypothesis was correct, which it is not,[1] it does not explain why refiners would construct *inefficient* marketing networks to ''move'' their crude oil. One would think that more crude might have been ''moved'' if the products refined from it could be sold at lower prices through more efficient distribution outlets. Indeed, if crude production and trading were highly profitable, no rational refiner-marketer would intentionally whittle those profits away by building and operating an inefficient distribution network.[2] Moreover, if by miscalculation a refiner-marketer mistakenly constructed a network that turned out to be inefficient, it defies logic to understand why it would purposefully ''maintain'' this inefficiency in order to ensure that its profits would be diminished ''for almost 20 years'' (Director's Argument, Volume 1, page iv).

The Director's continued inability to provide a logical, supportable basis for his assertion that refiner-marketers' branded networks in the 1950's and 1960's were inefficient stems from his continuing refusal to recognize the much more logical and empirically supportable explanation that has been presented to the Commission by the witnesses who appeared for the major refiner-marketers. These witnesses explained why the branded full service networks arose, why they were efficient and why they have changed over the last decade.

As Texaco Canada explained in its Refining and Marketing Submission, the full service branded retail networks arose as a response to consumer tastes and preferences. During the 1950's and 1960's, most consumers preferred the amenities and locational convenience of full service and were willing to pay for them. Full service retail gasoline outlets sometimes sold less product at somewhat higher prices than retail gasoline outlets offering fewer or no services, but this does not suggest that full service outlets were ''inefficient.'' It merely suggests that providing service and locational convenience entails higher costs than not providing these benefits. The Director has offered no evidence to support the implicit assumption in his ''efficiency'' argument that most consumers in the 1950's and 1960's preferred fewer services and lower prices. Indeed, all of the authoritative evidence before the Commission on this point indicates that the Director's assumption is wrong.[3] The branded full service networks of the 1950's and 1960's were not ''inefficient'' at all; they merely offered a different, and more expensive, combination of products and services than independent reseller outlets, a combination which most consumers preferred. (See Texaco's Refining and Marketing Submission, pages 151-52 and note 81.)

As Texaco Canada has demonstrated through its witnesses (whose testimony in this regard the Director did not challenge), the rationalization of the branded full service networks that refiner-marketers carried out in the 1970's was a response to changing market conditions, prompted by changing consumer preferences and changing economic factors (Texaco's Refining and Marketing Submission, pages 101-103 and 111-12). The Director continues to ask why this rationalization did not occur much earlier (Director's Argument, Volume 3, page 1) and why it was not accomplished more rapidly (Director's Argument, Volume 3, pages 2 and 8). Although the Director does not answer either question, the answer is clear. The branded networks were not transformed radically in the 1950's or the early 1960's because there was no need to do so: they met the needs and preferences of most motorists. By the late 1960's and early 1970's when consumer tastes and preferences began to change, rationalization did not occur immediately because: (1) many consumers still preferred full service; and (2) the economically proper response to changing market conditions is the gradual retirement or renovation of obsolete capacity, not its immediate closure. (See Texaco's Refining and Marketing Submission, pages 101, 111 and 127.)

The rationalization process that occurred during the 1970's is itself a powerful refutation of the Director's ''efficiency'' argument. When market conditions require it, refiner-marketers can and do adapt their retail networks to those changing conditions. This is the hallmark of ''efficiency,'' properly defined.

In the Green Books, in his Annual Report, in his Argument and in his letter of March 13, 1984, the Director persists in characterizing operations of independent marketers as efficient by comparison to those of refiner-marketers. He makes no effort to explain what he means by ''efficient'' nor does he outline the evidence upon which he relies. Some

marketers testified that they were efficient because their operations were small and inexpensive. Occasionally, questions were asked to permit a comparison of average annual sales.

It is not helpful to attempt to assess the simple operations of small jobbers by superficial comparisons with large refiner-marketers. Average throughputs are misleading without an analysis of the outlets that are being combined. Moreover comparisons between marketing operations of larger resellers and those of refiner-marketers are complicated to the extent that refiners must be concerned with efficiently manufacturing and distributing all products that are produced from crude oil.

Texaco Canada presented a panel of knowledgeable witnesses who addressed the efficiency issue in detail. They demonstrated Texaco Canada's "efficiency" by pointing to the extent to which the company has avoided costs that are borne by many of its competitors.

Texaco Canada explained the cost savings, and therefore efficiencies, that are gained by its innovations including its distribution system, its operation centre, its computerized processes for inventory control and electronic billing. Texaco Canada showed the extent to which its efficiencies result from systems that are vertically integrated. The Director made no real effort to question or contradict this evidence and nevertheless made the following statement at page 11 of his letter of March 13, 1984:

> "The evidence indicates that the independent marketers were more efficient than the marketing arms of the integrated majors"

What evidence? It is submitted that any comparison, to be useful, should begin with an explanation of "efficiency" and a description of the evidence supporting the argument. If the Director concluded that independent jobbers, both large and small, are more cost efficient than refiner-marketers, why did he not produce and prove those costs and efficiencies before the Commission? Surely evidence of financial performance was available and would have been more helpful than the reiteration of the unsubstantiated general assertion that independents are more efficient.

Texaco Canada's evidence demonstrated its success in Canadian markets. It attracted and held customers in the face of vigorous competition. Its operations were efficient and profitable. Its submission was supported by evidence!

2. The Myth of "Predation"

In the Green Books, the Director accused Canada's major refiner-marketers of engaging in a variety of predatory practices. As Texaco Canada has shown in its Refining and Marketing Submission (pages 122-34), the Director's Green Book allegations of predation were based on a mistaken notion of predatory conduct and misanalysis of the evidence. Conspicuously absent from the Director's latest submission, however, is any proof or even allegation of predatory conduct, as that term is properly defined. Absent any evidence of predation, the various practices aimed at lowering prices that the Director describes, consignment, allowances, second brands and direct marketing, must be recognized as pro-competitive practices that benefit the consumer through lower prices.

3. *The Myth of "Harmonization"*

The cornerstone of the Director's Green Book theory of anti-competitive behaviour was the Director's allegation that the major refiner-marketers followed a "conscious" policy of "harmonizing" their marketing practices in an effort to stifle competition from independent resellers. As Texaco Canada has shown, this Green Book allegation was false. (See Texaco's Refining and Marketing Submission, pages 114-22.)

In his latest submission, the Director does not attempt to rebut Texaco Canada's argument. Indeed, although the Director frequently refers to refiner-marketers collectively in his latest submission (See, *e.g.*, Director's Argument, Volume 3, pages 2, 15, 55 and 102), he does not resurrect the Green Book "harmonization" argument.

The reason is simple: much of the evidence presented at the hearings undermines his argument. For instance, the Director's description of allowance programs and consignment programs demonstrates wide differences among refiner-marketers (Director's Argument, Volume 3, pages 12-79). Similarly, the evidence indicates that some refiner-marketers use second brands, others do not, and those that use them do so in different ways and at different locations (Director's Argument, Volume 3, pages 80-105). The Director's evidence underscores the fact that refiner-marketers follow markedly different policies with respect to supplying resellers, the extent to which and the manner in which they engage in direct marketing, the manner and scope of the rationalization that they are carrying out, and the extent to which they use private brand agency agreements and management contracts (Director's Argument, Volume 4, page 238-69 and Volume 5, pages 355-418).

In short, the Director's evidence establishes that each refiner-marketer adopted its own policies with respect to most of the practices the Director has identified. As explained in Texaco's Refining and Marketing Submission (pages 114-18), such diversity (which, if anything, has increased since the Green Book period) refutes any suggestion that the actions of refiner-marketers were in any way coordinated or "harmonized."

B. The Director's Latest Submission Establishes That the Green Books Are Inaccurate, Unproven and Irrelevant.

In his latest submission, the Director has ignored many of the critical allegations of the Green Books and, in the process, has provided further evidence of their inaccuracy. Although at one point he states that the Green Book period practices he describes are "[o]f particular concern" and should be "carefully" reviewed by the Commission (Director's Argument, Volume 5, Conclusion, page 10), the Director then shifts his ground and argues that "it is important to recognize the change in competitive circumstances in the post 1973 period" and that "the policies of majors today" are not the same as those of the Green Book period.[4] Moreover, the Director concedes that "the rationalization carried out by the majors in the last decade will no doubt enable the integrated firms to match the efficiency of the leading independent marketers" and that this development "will promote competition in petroleum retailing."[5]

III. THE DIRECTOR'S NEW ARGUMENT

Because the Director's Argument rests on a misunderstanding of both the evidence before the Commission and the workings of the retail gasoline market, Texaco Canada must respond in some detail. For convenience, the company's answer will be organized in a manner similar to that used by the Director.

A. The Director's Allegations of "Controlling the Resellers."

The bulk of the section of the Director's Argument entitled "Controlling the Resellers: 1958-1973" (Volumes 3 and 4, pages 4-236) is inconsistent with his own view of what has taken place in the marketplace since 1973. According to the Director, since 1973, the "integrated companies are no longer attempting to control the resellers" (Director's Argument, Volume 3, page 3). If this is so, it is difficult to see why his detailed descriptions of refiner-marketers' supposed efforts to "control the resellers" during the Green Book period are relevant. Nevertheless, some response to this material is necessary, if only to point out the Director's tendency to mistake pro-competitive practices for anti-competitive behaviour.

1. Temporary Allowances

The Director argues that allowances enable refiner-marketers "to deal with isolated pockets in price competition" (Director's Argument, Volume 3, page 54). This suggestion had been part of the Director's Green Book allegation of predation. As Texaco Canada stated in its Refining and Marketing Submission (pages 132-33), allowing refiner-marketers, like other marketers, to tailor their pricing responses to local market conditions enhances market efficiency and is pro-competitive, not anti-competitive. For this reason, Texaco Canada has given temporary allowances not only to its retailers but to independent resellers as well. To the extent that the Director's suggestion is intended to be a vague reference to price discrimination, the allegation is discussed below.

According to the Director, allowance programs "contain elements of resale price maintenance" because they enable a refiner-marketer "to indirectly influence the level at which [its] dealers price" (Director's Argument, Volume 3, page 14). He also asserts that certain allowance schedules "effectively lead[] price upwards" and that, by withdrawing allowances, a refiner-marketer may send "quick messages" to its dealers, presumably to raise prices (Director's Argument, Volume 3, page 54).

The Director misunderstands the purpose and effect of allowance programs. As Texaco Canada's witnesses testified, Texaco Canada's Retailer Assistance Plan (RAP) is a mechanism through which Texaco Canada provides incentives for its dealers to pass through reductions in effective wholesale prices to consumers:

> Q. With respect to the RAP, and you have described how it works, why would you not just lower the dealer tankwagon?
>
> A. (Taylor) Because if we lowered — because we wanted to make sure the reduction was passed through to the pump price.
>
> (Transcript Volume 122, page 23022. See also Texaco's Refining and Marketing Submission, pages 130-31, 157, 162-63.)

The Director does not deny that RAP has this effect; indeed, the evidence shows that the effect of RAP is to enable a dealer to price at a lower level while maintaining essentially the same margins.[6] (See Exhibit M-337.)

Instead, the Director concentrates on those occasions where Texaco Canada either discontinued RAP in a market area or where Texaco Canada revised its allowance schedule by increasing the price level at which it was willing to offer support. He argues that both of these practices provided dealers with an incentive to raise prices (Director's Argument, Volume 3, pages 16 and 18-21).

The Director's argument should be rejected. While it may well be true that, when Texaco Canada discontinues RAP in a given area, dealers are motivated to increase their prices, the incentive for dealers to raise prices under such circumstances is no different than the incentive of any retailer to increase his prices when his wholesale price is increased. Indeed, the discontinuance of RAP is, effectively, an increase in wholesale prices to the dealer. That the increase follows the removal of an allowance rather than an increase in dealer tankwagon prices (DTW) is irrelevant from a competitive standpoint. Removal of the allowance provides no greater incentive to the dealer to raise prices than would an increase in DTW. Thus, the Director has only shown that an increase in wholesale prices provides retailers with an incentive to raise their retail prices.

The Director's argument with respect to the effect of reducing RAP support by raising the price level at which Texaco Canada is willing to provide assistance is equally unsound. Like removing allowances, increasing the support price level increases effective wholesale prices. Although the Director asserts that Texaco Canada's allowance program ''enabled Texaco to lead a very substantial price restoration in Ontario and Quebec in [May] 1983'' (Director's Argument, Volume 3, page 21), he ignores the fact that, had Texaco Canada accomplished the previous price cuts through lowering DTW rather than by implementing RAP (as the Director apparently would prefer),[7] the May 1983 ''price restoration'' could have been accomplished just as easily by a commensurate increase in DTW.

There is one respect in which use of RAP during periods when retail prices are increasing does differ from direct adjustments in wholesale prices. Just as implementing an allowance program helps ensure that wholesale price cuts are passed on to consumers, increasing wholesale prices through an increase in the support price helps ensure that retailers increase their prices by *no more than* the amount of the wholesale price increase, as long as they remain on RAP. Thus, use of RAP encourages dealers not to use a general price increase as an opportunity to inflate their own margins. To the extent that increasing wholesale prices through an increase in the support price level has this effect, the system is socially beneficial.

This point brings us to the Director's ''principal'' criticism of allowance programs: that they contain ''elements of resale price maintenance'' (Director's Argument, Volume 3, page 14). There is a simple response. As the Director concedes, allowance programs ''do not give refiners direct control over retail prices''. Rather, he asserts that they allow refiners ''to indirectly influence the level at which their dealers price.'' But any supplier ''indirectly'' influences retailers' prices by changing wholesale prices. RAP does just this; its only other feature is to encourage retailers to keep prices *low* by conditioning the degree of support on retail prices. But the Director does not, and cannot, criticize this beneficial element of RAP since dealers are free to decline RAP, and some dealers do so.[8]

Allowance programs enhance efficiency by promoting greater output and lower prices. No public benefit would be served by eliminating this ''indirect'' effect of encouraging lower prices, thereby increasing dealers' incentives to charge higher prices to consumers. The only beneficiaries of such a policy would be branded dealers and their independent reseller competitors, who would have greater incentive and ability to enjoy higher profits.

2. Consignment

The Director contends that refiner-marketers use consignment ''to obtain greater control over price in the marketplace'' (Director's Argument, Volume 3, page 55). He finds these programs offensive because, in his view, refiner-marketers use them to avoid the price maintenance and price discrimination provisions of the Combines Investigation Act (Director's Argument, Volume 3, page 79).

The Director's description and criticism of Texaco Canada's use of consignment is largely moot. As the evidence before this Commission makes clear, with the exception of a few outlets, Texaco Canada no longer uses consignment as an alternative form of temporary support to dealers; the company relies almost exclusively on RAP for that purpose. (See Transcript Volume 122, pages 22989-96 and Texaco's Refining and Marketing Submission, pages 161-63 and 169-71). Texaco Canada's use of consignment is primarily restricted to those outlets, such as second brands and self serves, where Texaco Canada participates directly in the retail market through its contracted retailer agreement accounts (''CRA'').[9] Thus, even if one were to assume that the Director has correctly analyzed the evidence on which he relies, the lengthy description and criticism of Texaco Canada's use of consignment in the 1960's and early 1970's contained in the Director's latest submission is, much like the Green Books, irrelevant to the marketplace today.[10]

However, in addition to being irrelevant, the Director's criticism of Texaco Canada's use of consignment in the 1960's and early 1970's is unwarranted. The Director simply fails to understand the complexities of devising appropriate pricing strategies in a variety of diverse local markets.

The Director first contends that the consignment programs used by Texaco Canada in the Green Book period gave the company ''greater control over price.'' He also argues that consignment ''had the additional advantage'' of avoiding ''price discrimination.'' He finally asserts that consignment permitted ''greater selectivity'' than allowance programs[11] (Director's Argument, Volume 3, pages 57-60). As the passage from the transcript on which he relies makes clear, however, this ''control'' was necessary in ''volatile'' or ''soft markets'' because it enabled Texaco Canada to respond more rapidly to changing market conditions (Director's Argument, Volume 3, pages 59-60 quoting Transcript Volume 122, page 22981 and Exhibit M-327). In short, consignment allowed Texaco Canada to ''recognize market conditions as they effected [sic] individual locations'' (Director's Argument, Volume 3, page 60, quoting Transcript Volume 124, pages 23253-55).

The Director does not explain why it is anti-competitive for refiner-marketers such as Texaco Canada to tailor their retail pricing strategies to the special conditions of particular markets. As explained in Texaco Canada's previous submission, a refiner-marketer, like any marketer with outlets in more than one market, should be free to respond quickly to changing market conditions by adjusting prices at each outlet only by the amount required by the

supply and demand conditions present at that outlet.[12] Such responses are not only not anti-competitive, they are socially beneficial: they enhance efficiency by facilitating overall market responsiveness to changing supply and demand conditions.[13]

3. *Second Brands*

According to the Director, second brands ''raise two competition policy concerns.'' The first is that second brands are supposedly ''targeted'' at independents. The second is that second brands were used by refiner-marketers ''to extend their control over the market'' (Director's Argument, Volume 3, pages 81-82).

The Director admits that, contrary to his Green Book allegations, second brands have proved to be a permanent feature of the Canadian marketplace and that they are not temporary devices designed to destroy or discipline competitors (Director's Argument, Volume 3, page 102). But the Director attempts to sidestep the effect of this concession by adopting the arguments of two independents, Alex Hemstreet and Harry and Sylvia Rosen, who argue that they had been ''disciplined'' and who apparently feel that they have a right not to have their prices matched by their refiner competitors (Director's Argument, Volume 3, pages 102-04). The Commission should conclude from the evidence that Mr. Hemstreet closed his station in order to attract public attention and increase his sales. He had a large inventory of gasoline and accordingly realized an inventory gain when prices rose over the weekend and was able to open for business without interruption. Upon ''reopening'' he resumed his role in the market and continued to price aggressively. (Transcript Volume 59, pages 11565-73 and 11577-80, testimony of Mr. Hemstreet, see also Exhibits M-183, M-184, M-185, M-186, M-187, and M-188.) His assertion that he had been disciplined was not supported by the evidence.

The Director asserts that there are few independents who ''dare to adopt aggressive pricing policy'' (Volume 3, pages 104-05). The evidence does not support that conclusion. Competition in recent years has been vigorous, and both refiner-marketers and independents have participated. Independents continue to price at a low level. (See Exhibit M-77A.)

For a more objective assessment of the competition between independents and refiner-marketers, see the evidence of Gary Cushman (Transcript Volume 55, page 19862) and Robert Brodie (Transcript Volume 60, page 11837) in response to questions from members of the Commission. The Director's admission of a recent ''national price war'' is hardly suggestive of a market composed of meek and nonaggressive competitors.

The Director's concern about ''targeting'' ignores the obvious. Since second brand outlets, like most independent outlets, are designed to cater to those consumers who are more price sensitive and to take advantage of a marketing opportunity, it is not surprising that second brands and independents tend to be present in and absent from the same general markets.

Although the Director points to the scarcity of both second brands and independents in the Maritimes, he overlooks the fact that independents are free to enter these markets but have done so only in small numbers. Most of these markets are characterized by sparse population and low-volume outlets; such markets are ill-suited to the high volume, price-oriented strategy used by both second brands and independents. The Director's targeting argument amounts to a

criticism of what one would expect to see in a keenly competitive national market: outlets with similar offerings tend to be located in the same areas.

The Director's next concern about second brands is equally unfounded — his fear of "control". The Director does not define what he means by "control" nor does he set forth a rational explanation as to why "control" is harmful.

If by "control" the Director means Texaco Canada's policy of selling gasoline directly to the public through CRA arrangements (Director's Argument, Volume 3, pages 96-97), his criticism is misplaced. Elsewhere the Director contends that the refiner-marketers recognized that independents were able to develop efficient price-oriented marketing strategies due in no small part to the use of direct marketing through low-overhead salary and commission operations. (See *e.g.*, Director's Argument, Volume 3, page 6.) Texaco Canada uses its price-oriented second brand outlets to gain these same efficiencies.[14] The Director makes no effort to explain how this practice, which he views as "efficient" when used by independents, becomes an anti-competitive practice of "control" when used by refiner-marketers.

But the Director's argument about refiner-marketers' use of second brands "to control the market" is not simply unfounded; it is pernicious. The Director's argument is a criticism of the decisions of refiner-marketers to participate directly in the growing market segment of price conscious consumers rather than, as the Director apparently would prefer, to cede it to the independents (Director's Argument, Volume 3, page 82). Acceptance of this argument would limit competition, not promote it. (See Texaco's Refining and Marketing Submission, page 134.)

4. Acquisitions

The Director details and severely criticizes the acquisitions made long ago by each of Canada's refiner-marketers. But, with the possible exception of Imperial's arrangement with Sunys, "major" refiner-marketers in Canada — Texaco, Imperial, Shell and Gulf — have made no significant acquisitions of marketing outlets during the past sixteen years.[15] Instead, the acquisitions that have occurred have been made by smaller regional refiners (primarily Ultramar) and by the government's own oil company, Petro-Canada. (See Director's Argument, Volume 3, pages 124-26, Table 1; Volume 5, pages 466-72, Appendix II.) This dearth of acquisition activity by the "majors" does not justify the Director's lengthy criticism, much less a specific proposal directed at limiting refiners' ability to acquire marketers beyond those restrictions already imposed by law. (Director's Argument, Volume 5, Conclusion, pages 14-15.) The Director's argument concerning acquisitions is irrelevant to any meaningful analysis of competitive conditions in the Canadian petroleum industry.[16] Since the Director has conceded that entry barriers to petroleum marketing are low (Director's Argument, Volume 3, page 107), it is implausible to assume that acquisitions in the marketing area are likely to pose a competition problem. (See Texaco's Refining and Marketing Submission, pages 125-26.) The exit of some competitors from a market is not ordinarily troublesome as long as it is easy for others to take their place.[17]

5. Restrictive Covenants

The Director contends that various forms of covenants used by refiner-marketers in disposing of retail outlets — non-petroleum use covenants and covenants requiring the

purchaser of a retail outlet who uses it for petroleum marketing to buy only the products of the selling refiner-marketer — limited competition and were ''designed to limit the growth of the reseller'' (Director's Argument, Volume 4, page 151).

The Director has produced no evidence that these covenants had any material effect on competition in retail gasoline marketing. The Director points to passages in the transcript where independents testified that, when attempting to purchase outlets formerly operated by refiner-marketers, they encountered such covenants (Director's Argument, Volume 4, pages 141-51). The Director ignores two critical points.

First, he concedes that entry barriers to gasoline marketing have been and remain low (Director's Argument, Volume 3, page 107). As a result, restrictive covenants could not have had any significant impact on independents' ability to enter the market.

Second, by focusing on particular incidents rather than overall market trends, the Director gives the misleading impression that independents have been inhibited in their expansion. Between 1971 and 1981, when retail gasoline marketing in Canada was undergoing massive rationalization, the ''major'' refiner-marketers reduced the number of their outlets by 42 percent while non-refiners increased the number of their outlets by 13 percent (Director's Argument, Volume 5, page 357, Table 1). Moreover, the evidence clearly indicates that many of the petroleum marketers upon whose testimony the Director relies to support the proposition that restrictive covenants had an inhibitory effect faced little difficulty in acquiring outlets. Between 1976 and 1981, for instance, Mohawk increased the number of its outlets by 31 percent, Turbo increased the number of its outlets by 32 percent and Ultramar increased the number of its outlets by 43 percent. (See Texaco's Refining and Marketing Submission, page 104, Exhibit II-I.)

These figures are particularly damaging to the Director's argument when they are placed in the context of the Director's other argument concerning excess capacity in petroleum marketing. (See *e.g.*, Volume 3, pages 1 and 108-11; Volume 5, page 355.) The high level of growth of independent marketers during a period of general market-wide contraction strongly suggests that the independents encountered no significant difficulties in acquiring outlets. Because excess capacity existed, the Director's argument about the inhibitory effects of restrictive covenants makes little sense because he provides no rational explanation as to why the ''excess'' stations sold by refiner-marketers would not also be ''excess'' stations in the hands of others and therefore not economically suited to further use as retail gasoline outlets.

6. Price Discrimination

The Director's argument with respect to price discrimination is obscure. He does not contend that the law has been violated nor does he ask that the Combines Investigation Act provisions on price discrimination be broadened. (See letter of March 13, 1984, pages 20-23.) But for some unexplained reason, he still sees ''serious competition policy concerns'' in this area. The Director's presentation is largely composed of a series of vignettes which, according to the Director, are evidence of ''a constant policy by refiners to offer preferential prices to classes of trade other than resellers'' (Director's Argument, Volume 4, page 155). The record before the Commission does not establish the existence of anti-competitive, systematic price discrimination of the sort that apparently concerns the Director, much less activity that warrants either condemnation or prohibition.

The fallacies in the Director's price discrimination argument stem not only from his misstatement of the evidence but also from an erroneous treatment of its economic implications. (See Texaco's Refining and Marketing Submission, page 132.) In economic terms, price discrimination is the practice of selling at prices such that the ratio of price to marginal cost differs among customers.[18] Although the Director makes no effort to define what he means by "price discrimination", the evidence on which he relies indicates that what he finds offensive is not price discrimination in the economic or legal sense, but simple differences in price. Because the Director provides no data showing whether the costs associated with the instances of price differences he has identified are also different, and because he does not explore the possibility of other competitive justifications for the differences, his argument is reduced to little more than episodic support for the rather unstartling proposition that different classes of trade and different customers in different geographic areas are sometimes charged different prices.

Since the Director does not propose that all such episodic price differences be made illegal, absent the kind of systematic "practice" of discrimination now covered by the law, the existence of such differences should not be troublesome. Indeed, the Director apparently concedes that transitory, unsystematic price discrimination is often in the public interest (Director's Argument, Volume 4, page 154).[19] These flaws in the Director's argument will become apparent as the three "types of price discrimination" he mentions are analyzed.

a. *Price Discrimination between Resellers and Commercial Accounts*

Much of what the Director presents as evidence of price discrimination between resellers and commercial accounts is not price discrimination in economic terms or even in the simplistic sense of the same seller charging different customers different prices. Instead, it is evidence of situations where one refiner's bid for a commercial account was lower than the price that *another* refiner charged its jobber customer.[20] These are not examples of price discrimination at all but of vigorous price competition among refiners for commercial accounts.

Most of the other examples cited by the Director are not helpful because the Director presents no reasonable basis for determining whether the costs associated with the commercial account are similar to those associated with the jobber account, whether the jobber was buying on the same terms as the commercial customer, whether he bought product at the same time or whether there were other competitive explanations for the difference. Although the Director makes passing references to incidents where the jobber contracted for either a similar or larger volume than the commercial account at issue [see *e.g.*, Volume 4, pages 159 (Louis Drouin), 162 (Drummond Fuels), and 163 (H.W. Selig)], absent is evidence indicating whether other factors relevant to the transaction — such as transportation, credit or whether the jobber was a spot purchaser or a habitual underlifter.

The Director offers no evidence suggesting that these episodes are not simply examples of unsystematic price discrimination or are otherwise justifiable because of changes in market conditions. The Director refers to Texaco Canada's wholesale price increase to Ontario jobbers in August 1982, for example, but this increase was nothing more than a short-lived adjustment reflecting market circumstances, rather than a reflection of a continuing practice of discriminating against jobbers (Director's Argument, Volume 4, page 164).[21] In volatile

markets, particular prices will move up and down at different times and this fact should not be troublesome absent the kind of systematic practice of discrimination which the Director's scattered episodes do not establish.

Finally, the Director overlooks the fact that some of the episodes he describes occurred when a refiner bid low to meet the competition of other refiners. A refiner fearing that he might lose the volume being sold through a jobber because of a competing refiner's low direct bid might well decide to bid below his wholesale price to jobbers in order to meet competition on that commercial account. The refiner should not be forced to refuse to bid if he is unwilling to lower his wholesale prices to jobbers across the board. Nor should the refiner be forced to sell through a middleman (the jobber) if he decides that it is more profitable to sell directly.

b. *Price Discrimination Against Resellers in Favour of Branded Dealers*

The Director's evidence with regard to alleged discrimination between resellers and branded dealers contains little or no analysis of (1) whether any price discrimination he has identified is systematic; (2) whether the examples cited are simply instances of meeting competition; or (3) whether costs or other factors affecting the transactions are different.

The bulk of the Director's argument is not devoted to establishing whether discrimination existed but to attempting to refute the realization data presented by refiners. Neither the examples of supposed price discrimination nor the Director's effort to rebut the realization data appear to involve Texaco Canada. Such realization data as was presented indicated that refiner-marketers achieved higher earnings by sales through their own outlets as compared to sales to resellers. The evidence, therefore, shows that, far from being discriminatory, prices charged to resellers were fair.

c. *Price Discrimination between Branded Dealers and Other Company Owned Outlets*

The Director's final price discrimination allegation is that refiners supply their company owned, price controlled outlets on terms that discriminate against their branded dealers. With respect to Texaco Canada, the Director cites a single episode. In January 1982, Texaco Canada's tankwagon price in Scarborough was 37.1 cents per litre while a Regent station in the area was charging a retail price of 35.8 cents per litre (Director's Argument, Volume 4, page 180).

The Director's evidence with regard to price differences at dealer and company outlets proves nothing about price discrimination. First, Texaco Canada dealers in Scarborough were receiving or were offered RAP in January 1982. Consequently, the dealer tankwagon price was not their effective wholesale price and therefore reveals nothing about whether Texaco dealers were charged a different price or whether price discrimination took place. Second, even if Texaco dealers' effective wholesale prices were higher than the Regent retail price, that fact does not show discrimination. Texaco branded retailers receive valuable services and support from the company.

7. *Exclusive Dealing*

The Director recommends that ''the practice of exclusive dealing on motor fuel supplies to the branded dealer sector be prohibited'' (Director's Argument, Volume 4, page 227). This

recommendation is based on the Director's contentions that exclusive dealing provisions restrict branded dealers' ability to compete (Director's Argument, Volume 4, page 186) and that "Gas is Gas" (Director's Argument, Volume 4, page 227).[22]

The Director's assertion that exclusive dealing contracts restrict branded dealers' ability to compete is not sensible. The Director offers no reason why a refiner such as Texaco Canada, which distributes the bulk of its gasoline through branded dealers, would use exclusive dealing to inhibit the ability of its own dealers to compete. Indeed, the allowances that Texaco Canada and other refiner-marketers offer dealers confronted with retail price reductions, which the Director paradoxically criticizes, show the contrary.

The Director's attack on exclusive supply contracts reflects a complete disregard for the economic benefits of these contracts. Exclusive dealing contracts are commonplace in a wide variety of industries. Refiners and resellers enter into exclusive supply contracts because it is mutually beneficial for them to do so. From the refiner's perspective, exclusive supply contracts facilitate the planning of refinery operations, assuring refinery utilization rates and thereby lower refining costs per unit of output. They also enable the refiner-marketer to plan more efficient use of distribution facilities, thus lowering the necessary investment in storage facilities and transportation equipment. Exclusive supply contracts thus effectively lower refiners' costs, enabling them to sell their output at lower prices.

From the reseller's standpoint, exclusive supply contracts provide an assured source of supply and some degree of protection from the gyrations of the spot market. For branded dealers, such contracts also provide the competitive advantages associated with branded identification. They may sign a lease on land, improvements, and equipment which effectively lowers the amount of capital investment required for the dealer to market gasoline and provides him other opportunities to generate revenue in non-gasoline-related businesses.

Because exclusive dealing contracts often provide social benefits, when reviewed under the Combines Investigation Act they will be prohibited only if they have the effect of substantially lessening competition.[23] The evidence before this Commission supports no such conclusion.

To understand fully the infirmities of the Director's argument, it is necessary to consider all of the interrelated financial arrangements that typify the relationship between a branded dealer and a refiner. One situation involves facilities owned by a refiner and leased to a retailer for a relatively short term. Such leases typically include exclusive dealing clauses, and with good reason. If the refiner operated the retail facilities with its own employees, it would be nonsensical to argue that the refiner could not choose to sell only its own refined products. It is no less legitimate, and no more "anti-competitive" for the refiner to lease the facilities to an independent operator on condition that the operator purchase all of its gasoline from the refiner-owner. Indeed, use of lessees, rather than employees or agents, presumably reflects the refiner's economic judgment that this method of operation is cost effective for these facilities.

It is important to remember that refiners develop their retail facilities to sell their own gasoline, not because they want to enter the real estate business. To the extent that a refiner is forced, by a prohibition on exclusive dealing provisions in leases, to lease facilities to retailers who sell a competitor's gasoline, the prohibition would in effect be forcing the

refiner to leave the petroleum business and run its marketing department as if it were a real estate leasing business. The predictable result would be an increase in direct operation of retail facilities through employees or agents.

Similar considerations apply in the case of retailers who own their own facilities and who choose to enter into an exclusive supply agreement with a refiner. Dealers who own their own stations typically enter into a series of contracts with a refiner, including (in Texaco Canada's case) a Dealer Sales and Equipment Loan Agreement and, often, cross leases covering the real estate on which the station is located. (See Exhibit M-320.) Under these agreements, Texaco Canada may provide the retailer with valuable equipment at no charge. This equipment may include pumps, signs, lights and tanks. In addition, the company often provides a cash payment under the cross lease which the retailer can use to finance his operation.

Refiners compete among themselves to obtain retail outlets by service and financial packages that will be attractive to retailers with whom the refiner wishes to deal. Such packages lower the amount of capital that any retailer must raise independently, and they shift some of the investment risks from the retailer to the refiner. These advantages are obviously attractive to potential dealers, because they readily accept the most attractive package despite whatever ''disadvantage'' there may be in an exclusive supply agreement.

As in the lessee dealer situation, a refiner is providing a package of services and financial support in order to sell its own gasoline. If prohibited from using exclusive dealing contracts, refiners would have little reason to offer financial support to a would-be branded dealer. The alternative of separately pricing and selling the services that refiners supply to dealers might be theoretically available, but such a system would be cumbersome and expensive to administer.

It is important to appreciate all of the implications of the Director's criticism of, and apparent proposal to abolish, exclusive supply contracts. If such contracts were abolished, refiners would probably be forced to abandon most programs that provide financial support to dealers. If a refiner could not locate a sufficient number of dealers who were able to finance all of their operations without refiner support, his only choice would be to operate stations directly through employees or agents. Dealer networks of the type that exist today might disappear. The social and economic consequences of such a radical restructuring of the industry have obviously not been fully analyzed in the Director's presentation. Since the existing system has developed and justified itself in the context of a competitive marketplace, the Director should bear a heavy burden before requiring it to be dismantled. Texaco Canada submits that he has not met that burden.

B. The Director's Allegations Concerning Supply Policies

The Director contends that, prior to the 1970's, refiner-marketers were reluctant suppliers of independent resellers and that this problem ''has continued in the post-1973 period'' (Director's Argument, Volume 4, page 265).

The Director's argument is not supported by evidence. The Director concedes that since the early 1970's, all of the ''major'' refiner-marketers have substantially increased the percentage of their sales to jobbers. Texaco Canada sales to jobbers increased from 10 percent

of total sales in 1971 to 18 percent in 1981; (Volume 4, page 238); Shell's jobber sales grew from slightly over 4 percent of total sales in 1971 to over 9 percent in 1982 (Volume 4, page 247); Gulf's sales to jobbers grew from 9 percent of total sales in 1969 to 20 percent in 1980 (Volume 4, page 254); and Imperial's jobber sales rose from less than 1 percent of total sales in 1969 to over 20 percent by 1974 (Volume 4, page 254).

The Director attempts to sidestep this evidence by pointing to the ''1979-80 supply crisis.'' Thus, for all practical purposes, the Director's allegation that supply problems continued in the post-1973 period is the assertion that jobbers experienced ''supply difficulties'' during a supply shortage that actually occurred in the winter of 1978-79. What the Director ignores is that, despite the supply shortage, refiners such as Texaco Canada increased the percentage of their total sales devoted to jobber sales throughout the 1978-1979 supply crisis period. (See Texaco's Refining and Marketing Submission, page 18, Table IV-10.)

In Table 1, the Director refers to the testimony of thirty resellers who testified concerning ''supply difficulties.'' With respect to those resellers who testified concerning Texaco Canada, the Director ignores three critical points. First, all of the ''supply difficulties'' asserted by resellers concerning Texaco Canada arose during the 1979 supply shortage. Second, some of the ''supply difficulties'' described by certain resellers were discredited during cross-examination. Cross-examination of Glenn Robbins for instance, revealed that his accusations of refusals to supply and discriminatory price increases by Texaco Canada were wholly unwarranted because his contract with the company had expired over a year before the period in which he supposedly experienced ''supply difficulties'' (Transcript Volume 32, pages 7232-35, testimony of Mr. Robbins). Third and perhaps more importantly, the Director fails to mention, much less attempt to refute, the conclusions reached by the Ministry of Energy, Mines and Resources that, during the supply crisis of 1978-79 Texaco Canada made every reasonable effort to continue to supply its reseller customers at reasonable prices; the company fairly and equitably apportioned its available supplies among all classes of trade. (See Exhibit C-198A. See also Texaco's Refining and Marketing Submission, pages 193-96.)

Although the Director suggests that other refiners, such as Gulf, Imperial and Ultramar, reduced their supplies to jobbers during this period, (see Director's Argument, Volume 4, page 265) he ignores the implication of this evidence: refiner-marketers responded to the supply crisis in different ways, completely undermining any suggestion that refiner-marketers harmonized their behaviour. Refiner-marketers competed vigorously among themselves and the ''supply problems'' of 1978-1979 are no more than a manifestation of the natural problems that stem from any supply shortage.

The Director makes two further arguments. First, he attempts to belittle the substantial level of jobber sales by refiners such as Texaco Canada by contending that the majority of these jobber sales are to large independent resellers such as Canadian Tire (Director's Argument, Volume 4, pages 254 and 268). The Director misses the point. It should hardly be surprising that sales to large jobbers constitute the largest portion of refiner sales to jobbers. Moreover, he misconstrues the competitive significance of this fact. By his own admission, large resellers such as Canadian Tire are among the most ''efficient'' and price competitive of gasoline marketers. (See Director's Argument, Volume 3, page 8.) Indeed, the Director asserted that Canadian Tire, supplied by Texaco Canada, enjoyed ''tremendous'' public

acceptance and ''led the way in retailing gasoline at lower margins'' leading to ''price wars'' (Green Books, Volume VI, pages 362-63, quoting Document 6349-51, filed as Exhibit B-29).

Thus, refiners' willingness to devote the majority of their jobber sales to the larger marketers not only promotes market efficiency but severely undercuts the Director's suggestion that refiners engaged in anti-competitive behaviour in the jobber market. If, as the Director contends, refiners truly wished to inhibit the growth of independent resellers, one would think that they would have begun by restricting supplies to their larger and most efficient jobber customers who, by definition, pose the greatest risk to a refiner's own marketing network. As the Director concedes, that has simply not occurred.[24]

The Director's second argument is an effort to rebut the contention of several refiners that the difficulties faced by small jobbers in supply crises stem from their own decisions to purchase on a spot basis (Director's Argument, Volume 4, page 268). The bulk of the evidence shows that the very resellers that the Director says experienced supply difficulties were those resellers who habitually shopped the spot market and underlifted their contractual obligations to refiners. [(See *e.g.*, Texaco's Refining and Marketing Submission, pages 191-93 and Table IV-13; Transcript Volume 47, pages 9595-98 (testimony of Mr. Tracey) and Volume 50, pages 10065, 10068 and 10074 (testimony of Mr. Bernier).)] In adopting the complaints of these resellers, the Director is not presenting a competition policy problem at all; he is arguing for preferential treatment of one class or resellers.

C. The Director's Allegations of ''Controlling the Price''

Recognizing the changes that have taken place in the marketplace, the Director has attempted to develop a new theory of anti-competitive behaviour to explain the post Green Book period; he now accuses the refiner-marketers of engaging in ''initiatives ... to control retail prices throughout the marketing sector'' (Director's Argument, Volume 5, page 362). A more objective review of the record will show that it proves only the existence of a vigorously competitive market in which refiner-marketers have responded rationally to the economic forces facing them.

1. The Rationalization

The rationalization of refiner-marketers' networks that took place in the 1970's and continues today obviously presents a serious obstacle to the Director's effort to characterize refiner-marketers as ''inefficient.'' He tries to blunt the force of this evidence by (1) clinging to the Green Book assertion that the refiner-marketers' networks were ''inefficient'' in the 1950's and 1960's (Director's Argument, Volume 5, page 355); (2) asserting that, because refiner-marketers continue to use allowances and consignment, their networks must still be somewhat ''inefficient'' (Director's Argument, Volume 5, page 359); and (3) arguing that, even though ''rationalization will no doubt enable the integrated firms to match the efficiency of the leading independent marketers'' and ''will promote competition in petroleum marketing,'' the ''integrated companies' initiatives'' to ''control retail prices'' will ''counter any public benefit'' (Director's Argument, Volume 5, page 362).

The Director's first point, that refiner-marketers' networks were ''inefficient'' in the 1950's and 1960's, is not only incorrect; it is also irrelevant. (See Section IIA(1), *supra* and

Texaco's Refining and Marketing Submission, page 111 and note 3.) The Director's second point, that refiner-marketers' continuing ''subsidization'' of their dealers through consignment and allowance programs suggests that their networks are not yet ''efficient'', is similarly misguided.

The Director's ''subsidization'' argument appears to be premised on the assumption that dealer tankwagon price is the ''true'' wholesale price. Thus, the argument goes, where refiner-marketers offer consignment or allowances, they must be ''subsidizing'' dealers by pricing below the ''true'' wholesale price. As we have shown, granting allowances and consignment selling are methods used by refiner-marketers to induce dealers to pass through lower wholesale prices to consumers. (See Section IIIA(1) *supra*.) Thus, contrary to the Director's argument, these methods are ways of reducing wholesale prices to respond to short term changes in the marketplace. They are not hidden ''subsidies'' any more than any other temporary wholesale price cut is a subsidy. The Director can prove subsidization by proving the relative inefficiency of the branded dealer system, something he admits he cannot now do.

The Director's final point is that the increased efficiency and competition resulting from rationalization is offset by the refiner-marketers' ''initiatives'' to ''control'' retail prices. The Director is wrong. Close analysis of the Director's allegations of increasing ''control'' over prices by Texaco Canada reveals that this supposed ''control'' is exercised to *lower* prices. For instance, the Director criticizes allowance and consignment programs which, as the evidence shows, are used to *lower* prices. The Director also criticizes direct marketing by refiner-marketers, based largely on the complaints of dealers and other independent resellers who argue that low prices at these outlets inhibit their ability to compete. Finally, in the wholesale sector, the Director criticizes direct bids for commercial accounts by refiners because these bids are at prices lower than those at which other resellers bid.

The Director no longer attempts to assert that these prices are predatory. His present position appears to be that increased ''control'' for the purpose of lowering prices is anti-competitive even if the prices are not predatory. Thus, the Director is not arguing for competition but against it.

2. *Direct Marketing*

The protectionist underpinnings of the Director's latest set of allegations are made clear by his argument concerning direct marketing. He states that rationalization by refiner-marketers during the 1970's represented ''more than the closing of stations'' because it was accompanied by an increased number of outlets directly operated by refiner-marketers (Director's Argument, Volume 5, page 363).

Direct operation of retail outlets through commission or salary arrangements is particularly well-suited to a high volume, price-oriented marketing strategy[25] because it enables a marketer to control his prices and costs and to cut overhead. Independent marketers have used this form of marketing for years. (Transcript Volume 16, page 3149, testimony of Mr. Gagnon and Volume 30, pages 6798-6801, testimony of Mr. Hogarth.) As market conditions have changed and consumers have become more interested in price and less interested in service, refiner-marketers have revamped their networks by using a direct mode of operation at outlets, such as self serves and second brands, that cater to price conscious consumers. The volume figures cited by the Director establish that these efforts have been successful.

Thus, the Director's criticism of increased ''control'' through directly operated outlets amounts to nothing more than criticizing refiner-marketers for engaging in activity which, if done by any non-refiner marketers, the Director would, and indeed has, labeled ''efficient.''

3. *Private Brand Agency Agreements and Management Contracts*

The Director asserts that the ''latest vehicle that refiners have adopted to control the price of gasoline is called a Private Brand Agency Agreement'' (Director's Argument, Volume 5, page 367). The Director's accusation is false, at least insofar as he suggests any industry-wide ''trend.'' As his own evidence shows, Imperial is the only refiner in Canada that has adopted such agency arrangements. The management contract allegations made by the Director relate only to Sun. Thus, the Director's arguments on these matters, even if valid, can hardly support the industry-wide remedies he proposes.

Because the Director's allegations have no relation to Texaco Canada, no response is necessary. Texaco Canada merely notes that, although it granted price discounts to jobbers where necessary to keep their business, Texaco Canada exercised no control over the prices set by its jobber customer.[26]

4. *Price Restorations*

The Director points to the ''price restoration'' that occured in the spring of 1983 as an example of how refiner-marketers ''control prices'' (Director's Argument, Volume 5, page 420). The Director is wrong. In fact, much of the evidence he presents contradicts his own allegations.

A classic example of these contradictions is the Director's concession that, during the fall of 1982 and the spring of 1983, Canada experienced a ''national price war'' (Volume 5, page 420, quoting Mr. Miller of Turbo Resources). Throughout the Green Books and his latest submission, the Director has repeatedly argued that refiner-marketers use consignment, allowances, second brands and various other supposedly anti-competitive practices to obtain tight control over retail prices. The Director's admission of a ''national price war'' is clear evidence that, if the refiner-marketers had this purpose, they were remarkably unsuccessful.

There are other contradictions as well. The Director states that price increases generally occur at the initiative of one of the ''major oil companies'' (Director's Argument, Volume 5, page 421). As explained in Texaco Canada's previous submission, this fact is neither surprising nor indicative of anti-competitive behaviour. The Director seems to ignore the obvious fact that prices do increase on occasion and that, when they increase, some market participant must have initiated the increase. (See Texaco's Refining and Marketing Submission, page 119.) The first visible manifestation of any such price increase is likely to be a price increase by a major seller. That other marketers followed means that the seller who initiated the price increase guessed correctly about market conditions.[27]

Although the Director discusses at some length the May 1983 price ''restoration'' initiated by Texaco Canada in Ontario and Quebec, he neglects to mention that the restoration was far from uniform and, indeed, in many respects was unsuccessful.

Far from suggesting anti-competitive behaviour, the incident stands as an example of the intense competitive forces at work in the retail gasoline market. Texaco Canada increased its prices believing such an increase was warranted because of its persistent losses and its view of prevailing market conditions. Some competitors followed, others did not, and prices subsequently fell. The company decided to repeat its effort on June 7. This second effort also met with discordant responses in the marketplace. Such begrudging acceptance of price increases is strong evidence of a keenly competitive market (Transcript Volume 126, pages 23617-23623, testimony of Mr. Maddock and Mr. Taylor).

IV. THE DIRECTOR'S NEW RECOMMENDATIONS

The Director has appended to his latest submission several vaguely described and ill-defined proposals for the Marketing sector. Because the Director's proposals are for the most part sketchy and therefore difficult to interpret, Texaco Canada does not intend to respond to them in depth at this time but instead will await further explanation of these proposals. A few preliminary observations about them can be made at this time.

A. The Open Supply Proposal

The Director proposes that refiners "be prohibited from contractually requiring any retailer to purchase exclusively from that refiner" (Director's Argument, Volume 5, Conclusion, page 12). Although the mechanics of this proposal are far from clear, the Director apparently believes that this "open supply" proposal, by permitting a gasoline reseller to shop for new suppliers at any time and to contract for "whatever volume he considers appropriate," will result in increased competition among refiners for reseller customers. What the proposal ignores is (1) the evidence before this Commission that exclusive supply arrangements between refiners and resellers are often of short duration and that refiners presently compete vigorously for reseller customers; and (2) that exclusive supply arrangements of the kind used by Canadian refiners increase efficiency and lower costs, thereby resulting in lower retail prices.

As Texaco Canada has previously explained, a refiner-marketer and its branded dealers enter into exclusive supply contracts because both parties believe it mutually beneficial. (See Section IIIA(7) *supra*.) The Director's open supply proposal, however, would deprive refiners of the benefits of exclusive supply contracts. This change would make it unlikely that refiners would offer dealers the compensating benefits now offered in exchange for the exclusivity agreement, at least without additional charge.

The proposal would eliminate the efficiencies associated with exclusive supply contracts. The refiner's ability to plan refinery output, inventory storage needs and transportation needs would be disrupted.[28] All refiners would lose these efficiencies under the proposal, and all would incur increased costs as a result. These increased costs would result in higher wholesale gasoline prices and, ultimately, higher retail prices for gasoline.

An additional complication results from the pattern of lease terms and product prices typically used in the petroleum business. The investment required for the land, improvements and equipment at many outlets operated by branded dealers was made by their

refiner-supplier. The refiner made these investments with the expectation that the investment would be recouped in part through profits on the sale of products to the dealer and in part through direct rental payments.

Under the Director's proposal, the refiner would lose its ability to recoup such investments. Refiners with investments in such outlets would have three choices. The first would be to terminate the dealer's lease arrangement and, where appropriate, remove the leased equipment. Unless the dealer could afford to purchase the station or the equipment himself, he would be forced out of the market.

The second option would be to increase the rental payments the dealer must pay on the land, improvements and equipment, assuming that this would be possible under the applicable agreements. Since dealers would be free to purchase gasoline from anyone they choose, the refiner would likely charge the dealer not only increased rents but also separately for all other services associated with a branded operation. The new arrangements would be more complicated and expensive to administer and these added costs presumably would be passed on to consumers. They would be similar to a ''rack pricing'' requirement of the type the Director now says he does not ''advocate.'' (See letter of March 13, 1984, page 24.)

The refiner's third option under the Director's proposal would be to terminate lessee dealers' leases as rapidly as possible and convert the outlets to direct operations. This option presumably would trouble the Director. Yet it might be the only practical option left to a refiner if the Director's proposal were implemented.

Before Texaco Canada can comment meaningfully on the proposal, the Director must deal with these inconsistencies in his approach and define the scope of his proposal more carefully.

B. The Director's Proposal That Refiners Be Prohibited From Controlling Retail Pump Prices of Non-Affiliated Outlets

This proposal appears to be directed primarily at eliminating allowance and consignment programs. As Texaco Canada has previously demonstrated, the evidence before the Commission shows that these programs are pro-competitive because they foster lower prices. (See Sections IIIA(1) and (2) *supra* and Texaco's Refining and Marketing Submission, pages 130-33.) The Director's proposal is therefore completely unjustified.[29]

Further meaningful analysis of this proposal at this point is not possible because the Director has not explained precisely what the proposal permits and what it prohibits. Texaco Canada notes, for instance, that although the proposal appears to permit refiner-marketers to continue to operate outlets directly, the proposal also appears intended to eliminate consignment, the method by which Texaco Canada sells gasoline directly to the public. (See Director's Argument, Volume 5, Conclusion, page 14.) Accordingly, Texaco Canada will present its view on this proposal in depth once the Director has clarified what he intends to propose.

C. The Acquisition Proposal

The Director proposes that ''any acquisition of retail capacity'' by a refiner be subject to RTPC approval (Director's Argument, Volume 5, Conclusion, page 15). This proposal is

completely unwarranted because, as previously explained, the Director has not shown that existing Canadian law is not fully adequate to protect against any anti-competitive acquisition activity in the petroleum industry. (See Section IIIA(4) *supra*.)

Like the Director's other proposals, this proposal is also plagued by definitional problems. It is far from clear, for example, what the Director means by "retail capacity." Consequently, further analysis must await a meaningful explanation by the Director of what types of acquisitions the proposal is intended to cover.

D. Interim Supply Order Proposal

The Director also recommends that the Combines Investigation Act be amended "to provide for interim supply orders" (Director's Argument, Volume 5, Conclusions page 16). Again, the proposal is ill-defined and unsupported by the evidence. (See Section IIIB *supra*.) While a complete response requires further clarification by the Director of how the proposal would operate, Texaco Canada strongly believes that, at a minimum, refiners should not be compelled to supply any particular new customer at the expense of old ones or to supply existing customers with a greater proportion of their historical liftings than other existing customers who have not invoked this proposed remedy.

E. Import Barriers Proposal

The Director's proposals on import barriers are too vague to justify any comment at this time. Because of the manner in which various government programs in the energy field relate to one another, any serious recommendation must deal comprehensively with all of the relevant federal and provincial programs and policies affecting energy imports and domestic pricing. Until the Director undertakes this task, Texaco Canada is not in a position to comment.

V. CONCLUSION

After reviewing all the evidence and submissions of the parties with respect to the marketing of petroleum products, Texaco Canada will ask the Commission to conclude:

1. There is vigorous and healthy competition in Canada today among integrated oil companies. As a result, the industry is efficient, products are reasonably priced and the public is well served.
2. There is a continuing role for all types of efficient marketers, be they major oil companies, independent chains, jobbers or dealers. All marketers are vigorously struggling to attract and keep customers.
3. The desire of some market participants for greater financial rewards should not restrain the competitive flexibility of refiner-marketers.
4. The continued competitive nature of the market, and its consequent efficiency, is guaranteed by the number and strength of the market participants, the prospect of imported petroleum products and the presence of a large government-owned oil company.

NOTES TO PART THREE

1. See J. Delaney & R. Fenili, Final Report: *The State of Competition in Gasoline Marketing,* pages 9-12 (U.S. Department of Energy 1981).

2. See *Id.*

3. See, *e.g.*, Texaco's Refining and Marketing Submission, pages 88-103 and sources cited therein; J. Delaney & R. Fenili, *supra,* pages 12-22.

4. Director's Argument, Volume 5, Conclusion, page 10. See also Volume 3, page 3 (''The competitive issues today, however are different from those prior to 1973. The integrated companies are no longer attempting to control the reseller, that day has past [sic].'') See also Volume 1, page iv (''the issues in the marketing sector have now changed'').

5. Director's Argument, Volume 5, page 362. See also Volume 1, page iv. (''there is every reason to believe [that outlets of refiner-marketers] are as efficient or will become as efficient as any retailer in the Canadian economy.'')

6. The Director makes much of the fact that, even when a dealer is offered RAP, he has the option of electing not to accept RAP and pricing at a level which gives him a larger margin than the margin guaranteed under RAP. (See Director's Argument, Volume 3, page 17.) He also argues that, under a ''sliding scale'' allowance program, a dealer has an incentive to raise his price (pages 21-22). While it is true that a dealer might possibly be able to earn a greater margin by refusing allowances and that, within a certain range on a sliding scale allowance program, a dealer might also earn a slightly higher margin by pricing at some level other than the bottom of the scale, the argument proves nothing. Were there no allowances, a dealer could earn a greater margin by increasing his price. The dealer's margin, however, is only one factor in the calculation to determine profits. The other factor is volume. The dealer may increase or hold volume by lowering his price. The key feature of any allowance program, which the Director conveniently ignores, is that, by guaranteeing a certain margin, it encourages the dealer to price at a lower level than he would without an allowance. Even on sliding scale programs, the theoretical possibility that dealers would sacrifice a large amount of support to get a small increase in margin, cannot provide a significant incentive to raise prices, given the volume effects that would result from the price increases involved.

7. Had Texaco Canada attempted to carry out its previous price cuts in this manner rather than through RAP, it is likely that consumers would not have enjoyed the full benefit of Texaco Canada's price cuts. (See Texaco's Refining and Marketing Submission, pages 130-31 and notes 96-100.)

8. See, *e.g.*, Texaco's Refining and Marketing Submission, page 163; Transcript Volume 90, pages 17479-80 (testimony of Mr. Pierre); Volume 8, pages 1266-67 (testimony of Mr. McKay); Volume 122, page 22976 (testimony of Mr. Taylor).

9. Texaco Canada's response to the Director's criticism of the company's participation in direct marketing through CRA accounts is contained in Section IIIC(2) entitled ***Direct Marketing,*** *infra.*

10. The Director's criticism of Texaco Canada's consignment programs during this period is contained in the Director's Argument, Volume 3, pages 57-60. At one point in his description, the Director refers to a ''Texaco internal memorandum of October 1982'' discussing possible reasons for using consignment (Volume 3, pages 58-59). As an examination of the document and the transcript where the document is discussed makes clear, the document is *not* an ''October 1982'' document but an October 1972 document. (See Exhibit M-327; Transcript Volume 124, pages 23251-55.)

11. The Director also asserts that consignment ''assist[ed] in price restorations.'' (See Director's Argument, Volume 3, pages 58-59, quoting Exhibit M-327.) As the testimony describing the document on which the Director relies to support this proposition makes clear, consignment ''assisted'' price restorations only in the sense that it enabled Texaco Canada to tailor the extent of its price increase to the specific market conditions existing in various local markets rather than increasing its prices across-the-board, which would have left many of its outlets ''exposed to lower prices.'' [See Transcript Volume 124, pages 23253-5 (testimony of Mr. Krantz).] As explained *infra,* consignment enables Texaco Canada to respond to specific market conditions in this fashion, promotes market responsiveness and is in no sense anti-competitive.

12. Texaco's Refining and Marketing Submission, pages 132-33 and note 97. The Director apparently does not contend that Texaco Canada's use of consignment actually violated the Combines Investigation Act. Since, as explained above, consignment promotes market efficiency by enhancing the ability of refiner-marketers to respond to changing conditions in local markets, Texaco Canada believes that there is no justification for expanding the Act to proscribe such pro-competitive conduct (pages 152-53 and note 97).

13. As one antitrust scholar observed, a seller's ability to make selective pricing changes is socially desirable because it allows markets to respond more quickly to the inherently fluid forces of supply and demand at work in the marketplace:

> Both general price rises and reductions in competitive markets — or, often, in other markets — are likely to begin with a seller altering a price here and there, testing responses, feeling for a better alignment with the powerful but only partially discernible forces to which he must conform. The evanescent discriminations of competitive markets are the sellers' antennae. This adjustment to shifting costs and demand is socially desirable, and it is best that appropriate responses be made as quickly and sure-footedly as possible . . . Seller's inability to raise or lower prices selectively, to feel for the balance of market forces, makes prices more rigid and markets less sensitive to changing demand and costs. The ability to make transitory discriminations is thus a valuable element in the continuing process of adjustment, and it is unfortunate that the law should interfere with such discriminations.
>
> R. Bork, *The Antitrust Paradox,* page 388 (1978).

14. See Transcript Volume 127, page 23793. (Texaco Canada uses CRA at second brands to control price ''and thereby achieve the volumes and earnings that we feel that particular offering will generate.'')

15. See Director's Argument, Volume 3, pages 124-26 (Table 1). Indeed, as Table 1 makes clear, no major refiner-marketer has acquired a marketer with more than eight outlets in the past twenty-two years. The Director makes a half-hearted effort to bolster his case in Appendix II of Volume 5, where he purports to list all acquisitions of gasoline marketers by refiners. This list indicates that Texaco Canada has made no acquisitions in the past seventeen years, Shell has made no acquisitions in the past eight years, Gulf has made no acquisitions over the past four years and only four minor acquisitions in the past thirteen years, and Imperial has made no acquisitions in the past fifteen years. (See Volume 5, pages 466-69, Appendix II.)

16. The Director also argues that a 1967 study by Texaco Canada concerning the burning oil jobber market in Quebec, and a 1969 letter discussing a possible acquisition, suggest that the company intended to acquire burning oil marketers during this period "to protect its own position" in the fuel oil market and to "control" price. [Director's Argument, Volume 3, pages 113-116 (citing M-340 and M-341).] Even if one were to assume that these dated documents are at all relevant to the current marketplace, the Director's argument overlooks two points. First, regardless of the possible motives for the proposed acquisitions discussed in these documents, the Director has presented no evidence that Texaco made any significant jobber acquisitions in Quebec after 1969. (See Director's Argument, Volume 3, pages 124-26, Table 1 and Volume 5, pages 446-72, Appendix II.) Second, the Director also neglects to mention that, since 1966, a number of new jobbers have entered the Quebec heating oil market, undermining any suggestion by the Director that acquisition activity in the late 1960's and early 1970's effectively eliminated jobbers from that market. (See Exhibit M-556, Texaco Canada Undertaking No. 11 (October 25, 1983); and Director's Argument, Volume 3, page 107.)

17. The Director's assertion that acquisitions removed price cutters from the market is untrue. (See Director's Argument, Volume 3, page 108.) In fact, it is contradicted by his own arguments elsewhere in the submission. He contends that, prior to their acquisition by various majors, Regent, Beaver, Graham and GTO were price cutters. These names should sound familiar because these brands are now used for chains that, in his second brand argument, the Director accuses of cutting prices (Volume 3, pages 102-03). Thus, it is far from clear that these acquisitions removed price cutters at all.

18. R. Posner, *Antitrust Law*, page 62 & n. 35 (1976); R. Bork, *The Antitrust Paradox*, page 383 (1978). Thus, although price discrimination may occur when a seller charges different customers different prices, the mere fact that a seller charges different prices is in no way indicative of price discrimination. Indeed, price discrimination may occur if the seller charges different customers the same price.

19. Dr. Waverman is in accord with most scholars on this point. (See, *e.g.*, R. Roberts, *Anticombines and Antitrust,* pages 212-14 (1981); R. Bork, *supra*, pages 389-91; R. Posner, *supra*, page 63.)

20. Every episode described by Mr. Rosen of Rosen Fuels falls into this category. (See Director's Argument, Volume 4, pages 157-58.) The Fueliner Limited episode, the Francis Fuel episode and the Louis Drouin episodes with respect to Imperial also fall into this category (pages 159-61).

21. See Director's Argument, Volume 4, page 164. The Director attempts to leave the opposite impression by inaccurately describing the evidence concerning Texaco Canada's jobber prices in Ontario during August 1982 and Texaco Canada's relationship with Mr. Gas. The August 1982 price increase to jobbers described in Exhibit M-644, Schedule C, Tab 1, was not related to the testimony of Mr. Gagnon of Mr. Gas, who testified before the Commission in December 1981. While it is true that Texaco Canada increased prices to twelve of its fifteen Ontario jobber accounts in August 1982, those prices were reduced later that same month. (See Exhibit M-644.) The brevity of the price increase, far from suggesting a systematic practice of price discrimination by Texaco Canada, merely underscores the keen competition in the jobber market which prevented the company from improving its margins on jobber sales.

    The alleged episode of price discrimination described by Mr. Gagnon of Mr. Gas to which the Director refers occurred in the summer of 1979. [Director's Argument, Volume 4, page 164, (citing Transcript Volumes 15-16, pages 2940-46, 3061-66, 3075, 3102-04 and 3135-42).] Mr. Gagnon complained that, during the summer of 1979, Texaco Canada reduced his discount on premium and regular unleaded gasoline without increasing its dealer tankwagon prices. (See Transcript Volume 16, page 3063.) That Mr. Gagnon's discount was reduced while tankwagon prices were not changed does not suggest price discrimination for two reasons. First, branded dealers also experienced a wholesale price increase during this time period, because Texaco Canada effectively increased its wholesale prices to dealers by reducing RAP at most of its branded outlets. (See Texaco's Refining and Marketing Submission, page 163 (Table IV-3); Transcript Volume 16, pages 3139-40.) Second, under his contract with Texaco Canada, Mr. Gagnon was free to change suppliers on seven days' notice if he believed that he could find a better price elsewhere (page 3137). Even after the price increase, Texaco Canada's prices to Mr. Gagnon were competitive (page 3138). That Texaco Canada continued to charge Mr. Gagnon a competitive price indicates that, rather than engaging in price discrimination, Texaco Canada was adjusting its price to Mr. Gagnon to conform to changed market conditions.

22. Director's Argument, Volume 4, page 227. The Director also argues that exclusive dealing contracts force branded dealers, when faced with lower prices from competing outlets, to face the ''Hobson's choice'' of accepting support or being priced out of the market. As previously explained, the dealer who is offered an allowance is free to set the price at whatever level he chooses; the allowance simply provides and incentive to the dealer to lower his price when he is faced with surrounding low-priced competition.The ''Hobson's choice'' faced by the dealer is dictated by the market, not his supplier. With respect to consignment, the refiner sets the price and the dealer receives a guaranteed commission, but for the reasons set forth above, this is not anti-competitive.

23. Combines Investigation Act. s. 31.4(2). See also R. Roberts, *supra*, page 309.

24. Indeed, at one point the Director states that, ''Faced with a shortage of supply the majors reduced their commitments to their least important customers, small resellers.'' (See Director's Argument, Volume 4, page 265.) The Director's statement amounts to a description of rational economic behaviour; in times of shortage, suppliers tend to reduce supplies to their least important customers.

25. Texaco Canada's consignment outlets, for instance, represented only 21 percent of the company's total number of outlets in 1982 but accounted for 47 percent of volume (Texaco's Refining and Marketing Submission, page 163). The statistics cited by the Director indicate that a similar situation exists with respect to other refiner-marketers' directly operated outlets (Director's Argument, Volume 5, pages 364-65).

26. See Transcript Volume 122, pages 23014-19. At one point, the Director leaves the incorrect impression that one of Texaco Canada's jobber customers, Mr. McCrimmon sought approval ''for any price changes while he was on support'' (Director's Argument, Volume 3, page 44). In fact, the ''approval'' to which the Director refers relates only to Texaco Canada's authorization of the wholesale price reductions requested by Mr. McCrimmon. [See Transcript Volume 93A4, pages 69-72 (in camera).]

27. The Director ignores the fact that attempts by a refiner-marketer to ''restore'' prices are not always successful. Indeed, the ill-fated attempt by Canada's largest refiner-marketer, Imperial, to raise prices in the summer of 1982 appears as an example. (See Director's Argument, Volume 5, pages 422-24.)

28. The extent of the disruption is impossible to determine because it is impossible at this point to decide what type of arrangements between refiners and resellers the Director's proposal permits. Are refiners free to enter into minimum volume contracts and if so, for what term? May dealers underlift their contract volume? The Director's proposal provides no guidance on these issues.

29. To the extent that this proposal is intended to alleviate any potentially anti-competitive effects of the private brand agency agreements or management contracts used by only two Canadian refiners, it is too broad.

APPENDICES

APPENDIX I

NATIONAL ENERGY BOARD
OTTAWA, ONTARIO
K1A 0E5

CANADA

OFFICE NATIONAL DE L'ÉNERGIE
OTTAWA, ONTARIO
K1A 0E5

CONFIDENTIAL

24 September, 1974

Mr. R. H. Davidson,
Senior Economic Adviser,
Policy Analysis Group,
Department of Consumer
and Corporate Affairs,
Canadian Building,
219 Laurier Avenue West,
Ottawa. K1A 0C9.

Dear Roy:

At our meeting on 12 September I said that I would review the Board's report on the landed prices of crude oil imported into Canada during the period 1968 - 1971 and if agreed to by the Chairman, provide you with a copy.

I am enclosing for the confidential use of your department the Board's report dated 5 October, 1972, a copy of which was transmitted to the Minister of National Revenue by the Honourable Donald Macdonald on 10 October, 1972.

Yours sincerely,

Jack Stabback

J. G. Stabback
Associate Vice-Chairman

Encl.

NATIONAL ENERGY BOARD

A summary discussion of general conclusions arising from examination of the landed prices of crude oil imported into Canada in the period 1968 - mid 1971

Introduction

This memorandum concerns the main conclusions and recommendations of a recent report to the Board from a Panel of its Members. The report was based upon a series of confidential surveys and interviews with importers concerning the landed costs of foreign crude oil in the period 1968 - mid 1971.

The Board monitors such costs primarily to obtain continuing adequate information and understanding of the relevant purchase and transportation arrangements. Although these activities bulk large in any importer's profit and loss account, the Board's monitoring of price and pricing does not in itself extend to other operations or transactions, nor does it involve audit or verification. Respondents' statements as to import prices are assumed to correspond to actual disbursements for the f.o.b. costs, insurance and freight concerned.

Results from these enquiries nevertheless entail significant implications. From the Board's point of view, apart from enabling some conclusions to be drawn, the work has provided what are less-than-autonomous importers with potent additional reason to seek the lowest costs for imported crude oil, without prejudice to activity by the Department of National Revenue. In some instances, the matter of crude oil pricing is without question being given more effective attention and the feedback by the Board of average survey results has improved the bargaining position of some importers.

Discussion

Inevitably, interest in this monitoring activity centres on price levels. During the period, there were in broad terms no readily defined or recognized "market prices", so that while the highly diverse circumstances of the importers required close study, judgment must play a large part in any conclusions over the reasonableness of prices paid.

Significant variances obtained among prices even for crude oils of the same or comparable qualities. Some prices were not open to challenge, others were higher than appeared warranted by prevailing market conditions and the aggregate costs reported to the Board were considered to be on the high side. In round terms, 40% of the total volume was regarded as bearing acceptable prices, some being at quite unexceptionable levels. A like proportion could not be so regarded, especially since its purchase seemed to reflect less than the fully-vigorous bargaining which may properly be expected. The remaining 20% fell variously between the extremes.

The Panel ventured to illustrate the relative magnitude of the "over-pricing" encountered, suggesting that it was on average some 10 cents a barrel. This appreciation, which it is stressed was given solely for the purposes of illustration, gives an aggregate of $20 million when applied to the volume of imports in 1970.

Note, however, that such an amount can not be regarded as an estimate from which an equivalent loss of revenue may readily be computed. First, the highly-priced oil contributing most to the conclusion regarding over-pricing was almost wholly bought from offshore subsidiaries of the importers concerned - a circumstance undoubtedly contributing substantially to the specific levels of price paid. Second, in some cases companies paying the lowest prices at one time were paying higher-than-average prices at another, so that questions arise over the offset of favourable performance against its converse. Third, as already implied above, net income assessed for tax involves items other than just the cost of foreign crude oil. Finally, there need of course be no doubt regarding the gulf that can lie between careful appraisal of 'fair and reasonable' price and its emergence as a basis of ultimate tax settlement.

The Panel dealt with other aspects of import pricing. Among these, the following examples have continuing relevance:

1. values shown in statistics of international oil trade, while of use in macro-economic applications, have limited utility in appraisal of specific prices.
2. examination of a company's prices and practices needs to be made with reference to its specific circumstances over periods longer than one year.
3. the enquiries made did not establish that consumer prices for oil products were affected by the arrangements in being.

4. analysis of prices and freights paid by importers revealed no uniformity of practice between corporate groups classified as to ownership, degree of integration or size.
5. appraisal of 'fair and reasonable' freights involves similar judgments to those needed in the case of f.o.b. costs of oil. Where arm's-length chartering occurs, it does not follow that the rates payable will be lower than those payable in inter-affiliate arrangements.

October 5, 1972

APPENDIX II

TABLE V

IMPORTED CRUDE COST ADJUSTMENTS BY NATIONAL REVENUE

TABLE V

IMPORTED CRUDE COST ADJUSTMENTS BY NATIONAL REVENUE

	IMPERIAL	GULF	TEXACO	IRVING	PETROFINA	SUNCOR	
1960							1960
1961			777,965				1961
1962			464,910				1962
1963			73,032				1963
1964							1964
1965							1965
1966							1966
1967							1967
1968							1968
1969							1969
1970							1970
1971							1971
1972							1972
1973							1973
1974							1974
1975							1975
1976							1976
1977							1977
1978							1978
1979							1979
TOTAL (COMPANY)			1,315,907				
TOTAL (AGGREGATE):							340,159,444

FOOTNOTES:

(1) CF figures represent adjustments to charter fees.

(3) amounts currently being contested by taxpayer.
(4) not reassessment forms issued as tax payable after adjustment reamined unchanged.

NOTE:

The information included in this table was provided to the Director by the companies listed

APPENDIX III

TAB 5 OF TEXACO CANADA'S REFINING UNDERTAKINGS, EXHIBIT R-122

In volume 108 commencing at page 20434, C. R. Thomson, during his cross-examination of the Director's panel of witnesses, Harries, Born and McCann, asserted that double counting was involved in the Director's Exhibit R-3, Appendix 3, Tables D & E. As a result of this double counting in the sources of supply, the percentage distribution of the uses of gasoline and distillates was not realistic.

Witness McCann indicated that he thought the assertion was correct but a detailed review of the specific ratios used would be required to answer the question fully.

In Volume 120, commencing at page 22524, Counsel for the Director queried the Texaco Canada witnesses, S. J. Walker and H. T. Hudson, regarding the double counting. The matter was not resolved and it was agreed that C. R. Thomson would respond in writing to explain how double counting on the supply side distorted the results derived on the disposition side and lead to an erroneous conclusion regarding the amount of product available to resellers.

> The subject matter might be expressed in a question posed in the following manner:
>
> "How and where is there double counting and, if so, in what manner did it cause there to be an unrealistic distribution in the uses of product?"

The double counting to which C. R. Thomson referred, was contained in the supply side of the equation used for the preparation of Exhibit R-3, Appendix 3, Tables D and E.

The supply of gasolines and distillates available to the major companies listed in Tables D and E consisted largely of products made in their respective refineries. Imports — and exports — of these products were too small to have significant effect on the total quantity available for distribution to consumers or resellers.

The Director's equation inflated this basic supply from refineries by adding the quantities received from domestic sources without recognizing that these quantities were offset largely and simultaneously by deliveries to the other companies engaged in the exchange transaction.

At any given time there is but one unit to deliver to the ultimate marketplace and that is the quantity made in the refineries, plus or minus current exchange imbalances, non-recurring sales or purchases, imports and exports and variations in inventories.

It is Texaco Canada's belief that the net quantity available for distribution after consideration of the foregoing deviations, is the amount which should be used as the denominator when computing the percentage distribution of end uses. A delivery on exchange is not an end-use of the product: it is simply a channel through which the product ultimately reaches the end-user.

The company analyzed the data from which Tables D and E were composed and compared them to data re-constructed by Texaco Canada to reflect what the company believes is the proper way to determine the percentage distribution of the end-use of gasolines and distillates.

The data used in the following comparative statements, include corrections made by Texaco Canada to its Return of Information on May 13, 1983.

STATEMENT I

	Line No.	Gasolines: Director's equation M³	%	Gasolines: Re-constructed by Texaco Canada M³	%
Sources:					
Production	5 minus 21	26,139	75	26,139	104
Domestic receipts	9	8,682	25	8,682	35
Domestic deliveries	12			(9,779)	(39)
Imports	10	0	—	0	—
Exports	4			(42)	—
Total		34,821	100	25,000	100
Uses:					
Deliveries on exchange	12	9,779	28	—	—
*Straight sales	13	4,422	13	4,422	18
*Own distribution system	15	20,578	59	20,578	82
Exports	4	42	—	—	—
Total		34,821	100	25,000	100

* Includes corrections to the Return of Information made by Texaco Canada on May 13, 1983.

STATEMENT II

	Line No.	Distillates: Director's equation M³	%	Distillates: Re-constructed by Texaco Canada M³	%
Sources:					
Production	5 minus 21	18,267	76	18,267	100
Domestic receipts	9	5,503	23	5,503	30
Domestic deliveries	12			(5,569)	(30)
Imports	10	223	1	223	1
Exports	4			(172)	(1)
Total		23,993	100	18,252	100
Uses:					
Deliveries on exchange	12	5,569	23	—	—
*Straight sales	13	1,907	8	1,907	10
*Own distribution system	15	16,345	68	16,345	90
Exports	4	172	1	—	—
Total		23,993	100	18,252	100

* Includes corrections to the Return of Information made by Texaco Canada on May 13, 1983.

Statements I and II above, as reconstructed by Texaco Canada now state fairly the distribution or uses of the net supplies available from the refineries and eliminate the gross-up, inflation or double counting of quantities which did not, in fact, enter the supply chain except momentarily and only on paper.

The data for Statements I and II were obtained from Exhibits filed by the Director and summarized by Texaco Canada in self-explanatory Statements D-1 and D-2 in respect to Gasolines and E-1 and E-2 in respect to Distillates. Copies of these statements follow.

It appears that Tables D and E as originally presented by the Director, were intended to show that the quantities of gasolines and distillates were restricted because of the amounts delivered on exchange or by direct sale to other major companies. This is not correct because there was a surplus of refining capacity in 1981 which could have been used to provide additional supplies for other purchasers or imports could have been arranged if bona fide requests for supplies had been received.

STATEMENT D-1

DIRECTOR'S ORIGINAL TABLE D APPENDIX 3

"PERCENTAGE DISTRIBUTION OF SOURCES & USES OF GASOLINE BY MAJORS: 1981"

WITH VOLUMES ADDED

000's M^3	Imperial		Shell		Gulf		Texaco		Total	
	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
Sources										
Total Deliveries, Line 5, Table A, Appendix 3, R5	10682		7948		9118		7073		34821	
Less: Total Receipts, Line 21	1813		2011		2572		2286		8682	
= Total Production	8869	83	5937	75	6546	72	4787	68	26139	75
+ Total Domestic Receipts, Line 19 (Supply Agreements)	1813	17	2011	25	2572	28	2286	32	8682	25
+ Imports, Line 20	0	0	0	0	0	0	0	0	0	0
Total	10682	100	7948	100	9118	100	7073	100	34821	100
Uses										
Total Shipments Under Exchanges, Line 12	2008	19	1738	22	3809	42	2224	31	9779	28
*Straight Sales, Line 13	1891	18	615	8	844	9	1072	15	4422	13
*Own Distribution System, Line 15	6741	63	5595	70	4465	49	3777	54	20578	59
Exports, Line 4	42	0	0	0	0	0	0	0	42	0
Total	10682	100	7948	100	9118	100	7073	100	34821	100

*Includes corrections to the Return of Information made by Texaco Canada on May 13, 1983.

STATEMENT D-2
RECONSTRUCTION OF THE DIRECTOR'S TABLE D APPENDIX 3
"PERCENTAGE DISTRIBUTION OF SOURCES & USES OF GASOLINE BY MAJORS: 1981"
WITH VOLUMES ADDED

000's M^3	Imperial		Shell		Gulf		Texaco		Total	
	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
Sources										
Total Production Line 5-21 Table A, Appendix 3, R5	8869	102	5937	96	6546	123	4787	99	26139	104
± Difference between Domestic Receipts (Supply Agreements) Line 19	1813		2011		2572		2286		8682	
and Domestic Deliveries (Supply Agreements) Line 12	2008		1738		3809		2224		9779	
	(195)	(2)	273	4	(1237)	(23)	62	1	(1097)	(4)
Imports, Line 20	0	0	0	0	0	0	0	0	0	0
Exports, Line 4	(42)	0	0	0	0	0	0	0	(42)	0
Total for domestic uses	8632	100	6210	100	5309	100	4849	100	25000	100
Uses										
*Straight Sales, Line 13	1891	22	615	10	844	16	1072	22	4422	18
*Own Distribution System, Line 15	6741	78	5595	90	4465	84	3777	78	20578	82
Total for domestic uses	8632	100	6210	100	5309	100	4849	100	25000	100

*Includes corrections to the Return of Information made by Texaco Canada on May 13, 1983.

STATEMENT E-1

DIRECTOR'S ORIGINAL TABLE E APPENDIX 3

"PERCENTAGE DISTRIBUTION OF SOURCES & USES OF DISTILLATES BY MAJORS: 1981"

WITH VOLUMES ADDED

000's M^3	Imperial		Shell		Gulf		Texaco		Total	
	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
Sources										
Total Deliveries, Line 5, Table A, Appendix 3, R5	8744		4797		6289		4163		23993	
Less: Total Receipts, Line 21	1322		1215		1954		1235		5726	
= Total Production	7422	85	3582	75	4335	69	2928	70	18267	76
+ Total Domestic Receipts, Line 19 (Supply Agreements)	1205	14	1215	25	1848	29	1235	30	5503	23
+ Imports, Line 20	117	1	0	0	106	2	0	0	223	1
Total	8744	100	4797	100	6289	100	4163	100	23993	100
Uses										
Total Shipments Under Exchanges, Line 12	1181	14	944	20	2324	37	1120	27	5569	23
*Straight Sales, Line 13	679	7	360	8	145	2	723	17	1907	8
*Own Distribution System, Line 15	6783	78	3452	72	3790	60	2320	56	16345	68
Exports, Line 4	101	1	41	0	30	1	0	0	172	1
Total	8744	100	4797	100	6289	100	4163	100	23993	100

*Includes corrections to the Return of Information made by Texaco Canada on May 13, 1983.

STATEMENT E-2

RECONSTRUCTION OF THE DIRECTOR'S ORIGINAL TABLE E APPENDIX 3

"PERCENTAGE DISTRIBUTION OF SOURCES & USES OF DISTILLATES BY MAJORS: 1981"

WITH VOLUMES ADDED

000's M^3	Imperial		Shell		Gulf		Texaco		Total	
	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
Sources										
Total Production Line 5-21 Table A, Appendix 3, R5	7422	99	3582	94	4335	110	2928	96	18267	100
± Difference between Domestic Receipts (Supply Agreements) Line 19	1205		1215		1848		1235		5503	
and Domestic Deliveries (Supply Agreements) Line 12	1181		944		2324		1120		5569	
	24	0	271	7	(476)	(12)	115	4	(66)	0
Imports, Line 20	117	2	0	0	106	3	0	0	223	1
Exports, Line 4	(101)	(1)	(41)	(1)	(30)	(1)	0	0	(172)	(1)
Total for domestic uses	7462	100	3812	100	3935	100	3043	100	18252	100
Uses										
*Straight Sales, Line 13	679	9	360	9	145	4	723	24	1907	10
*Own Distribution System, Line 15	6783	91	3452	91	3790	96	2320	76	16345	90
Total domestic uses	7462	100	3812	100	3935	100	3043	100	18252	100

*Includes corrections to the Return of Information made by Texaco Canada on May 13, 1983.

APPENDIX IV

Explanation of Error in Algebraic Formulae in Volume V of the Green Books

On page 3 of the Director's "Refining Sector" Green Book, Volume V, the following footnote appears:

> "1. Let Q_{ij} be the i'th firm's supply in the j'th region. Firm i produces only in i, firm j produces only in j. Then reciprocal arrangements that guarantee $\Delta Q_{ij} = \Delta Q_{ii}$, mean that
>
> $$\sum_j Q_{ij} / \sum_j \sum_i Q_{ij}$$
>
> is constant for any change in Q_{ij}, $i \neq j$."

This footnote contains two errors, one typographical and easily corrected, the other algebraic and fatal to the Director's Argument. It asserts a false proposition.

The Typographical Error

The Director in effect defines reciprocity by this equality: $\Delta Q_{ij} = \Delta Q_{ii}$. But this equality means that the change in firm i's supply in region j equals the change in firm i's supply in region i. This is wrong. A definition of reciprocity must involve both firm i and firm j. We submit the Director means $\Delta Q_{ij} = \Delta Q_{ji}$. This correction is used in the following analysis of the Director's algebraic error.

The Algebraic Error

Suppose that "for any change in Q_{ij}, $i \neq j$" means that $\Delta Q_{ii} = \Delta Q_{jj} = 0$. Then the Director's statement that

$$\text{``}\sum_j Q_{ij} / \sum_j \sum_i Q_{ij} \text{ is constant for any change in } Q_{ij},\ i \neq j\text{''}$$

is an assertion that the following is a valid equation:

$$(1) \quad \sum_j Q_{ij} / \sum_j \sum_i Q_{ij} = (\sum_j Q_{ij} + \Delta Q_{ij}) / (\sum_j \sum_i Q_{ij} + 2\Delta Q_{ij})$$

This equality reduces to

$$(2) \quad \sum_j Q_{ij} = (\sum_j \sum_i Q_{ij})/2$$

The Director's "equation" is in general not valid. It is valid if and only if

$$(3) \quad \sum_j Q_{ij} = \sum_j Q_{jj}$$

That is, the Director's assertion concerning constant relative market shares is true only when the relative market shares of the two parties to a reciprocal exchange are 50%.

On the other hand, the Director may not intend so to restrict ΔQ_{ii} and ΔQ_{jj}. In that case, the Director's statement of constant

$$\sum_j Q_{ij} / \sum_j \sum_i Q_{ij}$$

is an assertion that the following is a valid equation:

$$(4) \quad \frac{\sum_j Q_{ij}}{\sum_j \sum_i Q_{ij}} = \frac{(\sum_j Q_{ij} + \Delta Q_{ij} + \Delta Q_{ii})}{(\sum_j \sum_i Q_{ij} + 2\Delta Q_{ij} + \Delta Q_{ii} + \Delta Q_{jj})}$$

But this equation is also in general not valid. If $\Delta Q_{ii} = \Delta Q_{ij} = 0$, it reduces to equation (1) and is true under the limited circumstance discussed above. It is also true if

$$(5) \quad \Delta Q_{ij} + \Delta Q_{ii} = 2\Delta Q_{ij} + \Delta Q_{ii} + \Delta Q_{jj} = 0$$

For $\Delta Q_{ii} \neq 0$ and $\Delta Q_{jj} \neq 0$, equation (5) is true if and only if

$$(6) \quad \Delta Q_{ii} = \Delta Q_{jj} = -\Delta Q_{ij}.$$

Equation (6) will be satisfied, for $\Delta Q_{ij} > 0$, when the refineries of both parties to a reciprocal exchange are operating at absolutely full capacity prior to any ΔQ_{ij}. Of course, it could also be satisfied if the parties agreed that it should be satisfied and by agreement adjusted their supplies from their own refineries accordingly. The Director's footnote relies on no such agreement and the evidence discloses none.

Finally, equation (4) holds true more generally if

$$(7) \quad \sum_j Q_{ij} / \sum_j \sum_i Q_{ij} = (\Delta Q_{ij} + \Delta Q_{ii}) / (2\Delta Q_{ij} + \Delta Q_{ii} + \Delta Q_{jj})$$

Equation (7), however, is in general not valid, holding true only for particular values of Q_{ij}, ΔQ_{ij}, ΔQ_{ii}, and ΔQ_{jj}.

In sum, the Director's assertion is false.